No. 609.

In the Supreme Court of the United States.

OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY

AND

FIDELITY-PHENIX FIRE INSURANCE COMPANY OF NEW YORK,
Appellants,

v.

READING COMPANY, *et al.*,
Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

REPLY BRIEF FOR APPELLANTS.

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Of Counsel.

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CASES CITED.

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AGAINST

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REPLY BRIEF

of

CONTINENTAL INSURANCE CO., ET AL., APPELLANTS.

Introduction.

These appeals were occasioned by that part of paragraph 5 of the Plan which provides (R. 275):

> "Such no par value stock will be *sold* by the new corporation to the stockholders of the Reading Company, preferred and common, share and share alike, for $5,600,000., or $2.00 for each share of Reading stock" (italics ours).

In the Court below the appellees supported such sale and the Court approved it.

If what was decreed was a *real* sale for a proper consideration, the appellants would not be in this Court.

In the Court below and in their briefs submitted to this Court, the appellants contended that the method

adopted by the Reading Company was merely a pretense and was not a sale. The briefs of the appellees confirm this view. The Reading Company now protests that it did not in the Court below rely upon the *Union Pacific* dissolution to sustain the sale decreed in this case (although a reading of their brief in the Court below establishes the contrary). The view which the Reading Company now takes is that "the question of actual value" of the rights to the stock of the Coal Company "is not however of importance on these appeals." The appellees also concede in this Court that the right to purchase certificates of interest, denominated a right to "subscribe", is a valuable right, an admission inconsistent with the theory of a sale.

In short, the appellees have really abandoned the grounds upon which they supported the Plan in the Court below.* We recognize the exigencies which may at times compel the abandonment of a view taken in a court below on a question of law, but the question as to whether the transaction decreed in this case was or was not a sale, we submit, was then, and still is, not one of legal theory, but of fact. Lest there be any controversy over the principal ground upon which the Plan was supported in the Court below by the Reading Company we attach hereto, marked Appendix A, Point 1 of the brief of the Reading Company (and it is the Reading Company's Plan) and need only make reference to the Reading Company's answer to demonstrate that it was as a *bona fide* sale that it put forth the Plan and thereafter sought to support it (R 162-168, 169, 172).

The appellees seek reasons to support the *form* of a sale while abandoning its substance, as is evidenced by their briefs. That many of those reasons were not presented in the Court below, may very properly be re-

* The Iselin petition does not claim the Plan effects a dissolution. Its brief below mentioned a dissolution in fact.

The Kurtz brief below made a point that a dissolution was being effected.

garded as evidence of the necessities produced by the inability to support the theory upon which the Plan was devised and submitted to the Court below by the Reading Company.

The argument of the appellees is that the decree appealed from orders or involves a dissolution (not partial but complete) of the Reading Company, a dissolution in law, by reason of the merger of the Railway Company into the Reading Company; and in fact by reason of an alleged complete liquidation and winding up of the Reading Company's business. It is now contended that the essence of the Plan is neither distribution by way of dividend nor by way of sale, and that since complete dissolution of the Reading Company is involved all shareholders thereof should share and share alike. These contentions will be considered. Minor contentions are also advanced by the appellees, which, in the interest of brevity will not be considered in this reply brief.

I.

There is neither a dissolution in law nor in fact.

Confusion is attempted to be created by constant reference to "dissolution" of the combination in restraint of trade. It is well settled by the decisions of this Court that dissolution of a combination effected through a holding company does not require or involve the dissolution of a corporation. The Northern Securities Company was in itself, as was the reorganization of the holding company in 1896 in this case a violation of the Anti-Trust Act. The dissolution of the combination did not there, and does not here, require the actual dissolution of the holding company.

A corporation is a creature of a state under its sovereign powers. Dissolution thereof must proceed

through authority exercised by the State and in most cases through the action of the stockholders of the company. The decrees of Federal Courts do not dissolve a corporation created by a State. The Federal Courts may by mandatory injunction compel stockholders to vote for a dissolution or for dissolution proceedings to be instituted and effectuated. The Court below in this case undertook to compel no such action. Its decree was not intended to and does not compel specific action by the stockholders, but on the contrary requires the submission of the Plan to them for approval.

By the term "dissolution" under all the authorities can only be meant a death of the dissolved company, a surrender of its charter, a termination of the relationship between stockholders as such, and a distribution of all of the assets of the dissolved corporation after payment of debts. The term "dissolution" is capable of use in various connections and the definition is given in the interest of clarity of thought.

The plain facts are that the decree below neither requires nor involves a dissolution. The Reading Company, the very same defendant in this case, continues to exist. Its stockholders continue to retain precisely the shares of stock that they now own. The corporation does not wind up its affairs, it does not go out of business, it does not distribute all of its assets to its stockholders, nor even one-third thereof. It does indeed let go of one of its departments,—the coal business. It simply surrenders certain of the extraordinary powers conferred by its charter. Continuation under such charter, however, is far from death, and functioning as a going railway, is far from winding up. The corporation continues as the very same corporation, exercising the same powers which it may now exercise and does exercise, except that it has been deprived of its power to do mischief. Moral regeneration is not death.

Analysis of the decree below makes it almost too plain

for argument that the Reading Company, the defendant corporation in this case, continues in existence. In the introductory part of the decree reference is made to the "defendant Reading Company" (R. 287-290). Paragraph 2 of the decree provides that the Reading Company, the same as that previously referred to as the defendant, shall consummate the provisions of the modified Plan. The first paragraph of the modified Plan approved by the Court in its decree provides that the "defendants Reading Company * * * submit the following Plan", and proceeds to state that the Reading Company will assume the $96,524.000 General Mortgage 4% Bonds, will agree to save the Coal Company and its property harmless therefrom (par. 4 of the Plan), will agree with the Coal Company that at or before the maturity of the General Mortgage bonds (January 1, 1997) it will obtain a release of the Coal Company's property from the lien of the General Mortgage. It would obviously be impossible for a dead corporation to carry out the terms of any such agreement (R. 274, 275).

That the Plan provided, and the Court below intended, that the defendant Reading Company should carry out the agreement mentioned, and not some new corporation, is plain from paragraph 5 of the Plan, for when a new corporation was intended, the terms "new corporation" were expressly employed.

The Plan further provides that the Reading Company, the same defendant herein "will accept the Pennsylvania Constitution of 1874". This provision is wholly inapplicable if it was intended thereby to refer to a new corporation to be formed. It would be wholly idle to require a corporation formed in 1922 to accept the provisions of a Constitution of 1874. Such language is only applicable to the defendant Reading Company, a corporation organized in 1871, and contemplated as existing under its 1871 charter after the proceedings contemplated in the present case are consummated (R. 276, 277).

The language of paragraph 6 of the Plan is definite, moreover, that the Reading Company's present charter is to be retained. Said paragraph 6 provides:

> (R. 276): "The Reading Company will *merge* the Philadelphia & Reading Railway Company under the authority contained in the present charter of the Reading Company * * *". (Italics ours.)

The language is not that the Reading Company shall merge into the Railway Company (as stated in the brief on behalf of the Iselin Committee, pp. 5, 7, 29); not that the Reading Company and the Railway Company are to be consolidated into a third new corporation, but that the Railway Company is to be absorbed,

> "under the authority contained in the present charter of the Reading Company."

The Plan is thus clear to the effect that the present charter is not to be surrendered, but is to be retained. Similarly, paragraph 6 of the Plan provides that the defendant Reading Company

> "will proceed under the Act of 1856 to surrender those of its powers which are inappropriate for a railroad company of Pennsylvania" (R. 272).

If the Reading Company is dissolved, as now contended, and a new corporation is created, whether as a result of merger or consolidation, it cannot surrender such powers. It can only assume powers, given to it on its creation. The terms of the Plan that the Reading Company is to "surrender those of its powers", are applicable and applicable alone to the present Reading Company.

Certain provisions of the decree are so simple in their contradiction of the contention that the present Reading Company is to be dissolved, as to make the contention to that effect amazing. The decree provides that "the defendant Reading Company, the Railway Com-

pany, and the Coal Company shall proceed with due diligence, etc." (R. 297), and that this same "Reading Company is enjoined from receiving etc." (R. 298, par. 7). It is the defendant Reading Company which is enjoined, not some new corporation not yet in existence. If the decree below had contemplated a new corporation it would have provided, as it provided in the case of the New Coal Company that such new corporation become a party defendant in the case and enter its appearance so that the Court may have jurisdiction (R. 295). The distinction between an existing company and a new corporation, where a new corporation is contemplated, is shown in paragraph 3-k of the decree as follows:

> "The Reading Company and all persons acting for or in its interest are hereby perpetually enjoined from acquiring, receiving * * * any of the shares of the capital stock of the corporation; and the new corporation (*i. e.* the New Coal Company) and all persons acting for or in its interests are hereby perpetually enjoined * * *" (R. 295).

A dead corporation cannot be enjoined.

In dissolving the combination in restraint of trade we must accept the reorganization of the Reading Company in 1896 as an accomplished fact. The assets of the Reading Company have undergone a material and substantial change. In 1896 the assets of the Reading Company aggregated $193,000,000 (R. 232), whereas in 1920 they aggregated approximately $330,000,000 (R. 200). Changes equally material and substantial have taken place in the assets of the Coal Company (R. 198, 245).

All that the decree intended to do, was to separate the coal properties as they now exist from the Reading Company, and to strip the Reading Company of its power to violate the law.

Looking through the forms to the substance, the situation produced by the carrying out of the decree in this case is the same as that presented to the House of Lords

in *Will* v. *United Lankat Plantations Company,* and to this Court in the *Rockefeller* and *The New York Trust Company* cases. A branch of the business is segregated from the property of the corporation. The corporation continues to do business with the assets which it retains. In this case the Reading Company will obtain the income on the stocks and bonds which it owns and the revenue from the railway properties to which in substance it was heretofore entitled.

But the appellees say: "there is a merger of the Reading Company under the Pennsylvania Statute of 1909."

The Reading Company in its brief says:

> (pp. 68, 69): "It becomes appropriate to examine just what this merger is in form and effect * * *; it becomes necessary indeed to do so for the appellants are under evident misapprehension about it."

Such misapprehension if it existed, would be fully justified. The only provision in the Plan with respect to the merger is to be found in paragraph 6 thereof which provides as follows (R. 276):

> "The Reading Company will merge the Philadelphia and Reading Railway Company under the authority contained in the present charter of the Reading Company * * *"

There is no real assertion in the entire answer of the Reading Company of merger or consolidation. The brief of the Reading Company in the Court below will be examined in vain for any mention of any dissolution by reason of a consolidation or merger or the manner in which such merger would be effected.

The conclusion that a merger effects a dissolution is

bottomed upon the decision of the Pennsylvania courts in *Lauman* v. *Lebanon Valley Railway Co.*, 30 Pa. St. 42. That decision was followed in *Barnett* v. *Phila., etc., Market Co.*, 218 Pa. 649. The only significance of the reference to the *Lauman* case is that it establishes the right of a stockholder to enjoin a consolidation or merger until a deposit is made by the corporation with the court, sufficient to pay such stockholder the value of his stock, a doctrine peculiar to the law of Pennsylvania.

The briefs of the Iselin Committee and of Kurtz refer to the merger as taking place under the Pennsylvania statute of 1909. In point of fact, however, no merger under the statute of 1909 is ordered or required by the decree.

The Plan provides that the merger is by virtue of the authority in the original charter of the Reading Company. So far as the Reading Company is concerned no further authority was necessary. The argument now made by the appellees based upon proceedings under the Pennsylvania statute of 1909 is an afterthought.

The present contentions of the appellees are contrary to the statements in the answer of the Reading Company. The elaborate answer is that the Plan provides not a merger, not a consolidation, not a dissolution, but a simple sale of the Coal Company's stock.

But even assuming *arguendo* that the merger involves a technical dissolution of a corporation, the business, however, is not wound up, there is no distribution of assets and the rights accruing to stockholders upon dissolution are not brought into effect. The issue in this case is not to be confused by reference to the operation in a narrow and technical sense of a consolidation as a dissolution.

The rights of stockholders upon consolidation were fully considered in *Mayfield* v. *Alton Ry. G. & E. Co.*,

100 Ill. App. 614, affirmed in 198 Ill. 528. In that case the argument urged upon the court, which was practically the same as that urged here, was expressed by the Court as follows:

> (p. 623): "The line of argument is, * * * that upon consolidation the constituent corporations as independent entities cease to exist * * * that a stockholder in such case has the right to have the assets converted into money * * * and that a consolidation of a corporation is a winding up of the constituent corporations."

So contending, the plaintiff there, upon a consolidation, sought to obtain the value of his stock. The court in that case made a complete answer to the contention of the appellees here, as follows:

> (pp. 624, 625): "It is true, as counsel contends, that upon consolidation, all the duties and obligations of the constituent corporations, whether to the public or to private persons, are cast upon and must be performed and discharged by the consolidated corporation, but it was not the duty of the constituent corporation in which appellant held stock, to accept a surrender of his stock and pay him its value in money from the corporation assets, until such time as that corporation should reach the 'winding up' stage within the proper meaning. While for most purposes the constituent corporations cease to exist as independent entities, yet their corporate existence is not altogether ended, and regardless of legislation, in that respect they continue to exist, though under the new name, to such an extent as to preserve all their existing obligations unchanged, until in the fullness of time these obligations mature, and then the duty attaches to the consolidated corporation to pay, perform and discharge such obligation.
>
> *The winding up stage* of the constituent corporations, within the meaning of these words as applied to the time for distribution of the corporate assets, is not accelerated by the consolidation, and therefore the mere fact of consolidation will not give the

stockholder the right to have the corporate assets converted into money; nor is such consolidation a *winding up of the constituent corporations, within the proper meaning of these words* as applicable to the state of case set up in appellant's declaration." (Italics ours.)

In *Hale* v. *Cheshire Railroad Co.*, 161 Mass. 443, two railroads were authorized to consolidate on such terms as should be approved by the majority of each corporation. Each corporation had preferred as well as common stock. Consolidation was voted by the majority on the following terms:—each holder of four shares of the preferred stock of the Cheshire Railroad Company was to receive five shares of the preferred stock of the new company; and each holder of two shares of common stock was to receive one share of preferred stock of the new company. Two holders of common stock of the Cheshire Railroad Company brought a bill in equity to obtain their share of assets as upon a liquidation. In denying relief the Court said:

(p. 445) "The plaintiffs contend that common and preferred stockholders should stand on the same footing. That is true in the case of an ordinary liquidation or winding up of the affairs of a corporation, if there is nothing in the charter or articles to show otherwise; but the rule is not applicable to a case of consolidation like the present."

In the Matter of Interborough Consolidated Corporation, Bankrupt (District Court for the Southern District of New York, decided December 23, 1921, not yet reported), is a complete answer to the argument urged by the appellees that upon consolidation or merger, a dissolution in the sense of a winding up takes place. In that case a holder of preferred stock in one of the constituent companies, a New York corporation, filed a claim against the Consolidated Corporation based upon a provision in the certificate of incorporation of the constituent cor-

poration of whose stock he was a holder, and in the certificate of stock, which was as follows:*

> "In the event of any liquidation or dissolution or winding up (whether voluntary or involuntary) of the Company, the holders of the preferred stock (before any amount shall be paid to the holders of the common stock) shall be entitled to be paid in full the par amount of their shares and interest thereon at the rate of five per cent. per annum from the date of such liquidation or dissolution or winding up, the unpaid dividends accrued on their said shares until said date, with interest on such dividends at said rate from the respective times at which the same accrued, and the proportionate part of the dividend accruing at said date with interest thereon at said rate from said date. After such payment in full to the holders of the preferred stock, the holders of the common stock shall be entitled to receive the remaining assets and funds in proportion to the shares held by them respectively."

The Court, resting its decision upon the opinion of the Supreme Court of Illinois in *Mayfield* v. *Alton Ry. G. & E. Co., supra,* denied the claim. It must be clear that a provision in a stock certificate relating to a dissolution or winding up, does not contemplate a consolidation as within its terms. If a consolidation were within its terms we would reach the astounding result that a stockholder, either preferred or common, could vote in favor of a consolidation and then claim that under the provisions of the stock certificates he was entitled to the par value of his preferred or his common stock, as the case might be. No such result is ever intended by any such provision nor can it reasonably be contemplated.

* It is provided by Section 11 of the Business Corporations Law of the State of New York that a consolidated corporation assumes all the liabilities of the constituent companies. Under the law of the State of New York a consolidation effects a so-called "dissolution" of the constituent companies, *Miner* v. *N. Y. C.*, 123 N. Y. 242; *People ex rel. N. Y. Phone Co.*, 57 Hun, 486, aff'd on opinion below, 128 N. Y. 591; *Copp* v. *Colorado Coal & Iron Co.*, 29 Misc. 109.

In short, if the stock certificates in this case had specifically provided that upon any dissolution or liquidation or winding up, the holders of preferred and common would be entitled to an equal share in the assets of the corporation, suit could not be brought upon such provision of a certificate for the recovery of same, upon a consolidation of the corporation.

Whatever may be the effect of the merger, however, whether dissolution *vel non*, the distribution of New Coal Company stock is no part of such proceedings. A merger does not involve at all the actual distribution of such stock. The merger of the Reading Company and the Railway Company is one thing. This (so we assume *arguendo*), takes place under a Pennsylvania statute. The distribution of rights to New Coal Company stock, however, is quite another thing. It is this latter distribution to which the appellants object. The distribution of the New Coal Company stock is the unfair feature, and its demonstrated unfairness to the common stockholders is not altered by argument concerning another unrelated feature.

The matter may be made more clear by reference to the recent *Rockefeller* and *The New York Trust Company* cases. If in those cases, when the pipe line company stock was distributed to the oil company stockholders, the directors of the oil companies had gone through the extra flourish of merger with some other company, the distribution by way of dividend of pipe line company stock would have been none the less a dividend distribution.

The appellees contend further that the business of the Reading Company is liquidated in fact.

This is not true. The Reading Company is to retain by far the greater part of its present assets.* Its busi-

* The book value of the assets retained is $330,033,190.85 less the value of the Jersey Central stock ($26,000,000, R. 123) and the difference between $77,000,000 and $40,600,000 involved in the distribution of stock of the Coal Company.

ness continues. Simply one of its departments (a department which it never permitted to pay a dividend) is disposed of.

The Reading Company has admitted that such is the substance of the transaction. In its answer it says (R. 181):

> "The plan, if carried into effect, would dissolve the combination and deprive the Reading Company of its extraordinary powers and of its coal properties."

Perhaps the appellees contend that the assets of the Reading Company, other than the stock of the Coal Company, are being distributed in liquidation, on the theory that such assets are represented by the present stock of the Reading Company, and such stock of the Reading Company will be distributed to the present stockholders. But retention by all the stockholders of their stock is no liquidation. If this be a distribution by way of liquidation, then any company may liquidate by simple declaration without further action. This is the very feature of the present plan which shows conclusively that there is no liquidation. A liquidation or winding up necessarily involves a termination of the relationship between stockholders as stockholders. If stockholders continue to be related to each other as stockholders in a going concern, their rights continue without change. It is only in a case where stockholders cease to be stockholders of the dissolved company, and no further business is done by it as a going concern, that the corporation can be said to be dissolved.

The brief on behalf of the Iselin Committee states that this Court in effect required a liquidation of the Reading Company, in its provision that the shares of stock and bonds of the various companies held by the Reading Company should be disposed of in such manner as might be necessary to establish the entire independence from that company and from each other of the various companies

involved.* But the opinion of this Court contemplates that the various companies shall continue to exist and function, for the language is that "the affairs of all those now combined companies may be conducted in harmony with the law" (R. 37). This is language looking not to death, but to continued existence.

The present theory of dissolution is only put forward on appeal in a further effort to bolster up the guise under which preferred stockholders of the Reading Company, although continuing that company in business, and retaining their identical shares of stock, distribute to themselves a handsome dividend above 4%. The common stockholders object "not on a narrow question of technical right", as contended by one of the appellees, but to the essence of that unlawful feature of the Plan which violates the contract between the stockholders.

II.

If it be assumed *arguendo* that the Plan contemplates a dissolution of the Reading Company, nevertheless the preferred is not entitled to share *pro rata* with the common in the distribution of the assets.

The appellees maintain that upon a dissolution, preferred and common shareholders share alike in the distribution of assets. We submit that no such conclusion is warranted by the stock certificates in this case.

Shares of stock are not abstractions but specific and concrete contracts. The stock certificates are the contracts. What do they say as to dissolution?

The one provision about which there is no controversy is that the preferred stock is limited to non-cumulative dividends not exceeding 4% per annum. Once

* Even after the disposal of such stocks and bonds the Reading Company would hold assets exceeding $130,000,000.

the preferred stock has received its 4% dividends in priority to the common stockholders, it is entitled to no further participation in annual profits.

This limitation on the preferred stock is emphasized by that provision in the stock certificates which authorizes the Reading Company to redeem the preferred stock *at par*. Under this provision, however great may be the surplus of the Reading Company, the preferred stockholders would have to forego a participation therein.

The preferred stock was issued in 1896 in the main to previous creditors who were holders of Prior Preference Income Bonds of the old Company (R. 221-222). As holders of Income Bonds they had been entitled to non-cumulative interest not exceeding 5% per annum, payable only out of net earnings, if any, of the Railroad Company for the current fiscal year (R. 260-262). The failure of the Railroad Company to earn sufficient to pay such interest, forever destroyed any hope or prospect of the bondholders to obtain the interest for such fiscal year. The same rights were translated into preferred stock with this exception, made necessary by the slight difference in rights of bonds and preferred stock, namely, that as payment of interest is compulsory if earned, whereas the declaration of a dividend if earned is discretionary, the restriction was placed upon the use of net earnings of any previous year in which "full dividends" were not paid upon the preferred stock, so as to prevent an abuse of discretion. When the bonds matured the holders thereof would be entitled to the principal amount represented by the bonds. When the bonds were translated into preferred stock, it was not contemplated that the holders thereof should have their claims paid at more than par.

Since the preferred stock may be redeemed at par immediately prior to a dissolution, and a dissolution then effected whereby all of the remaining assets would be distributed exclusively to the common stock, it is not reasonable in any distribution of assets upon disso-

lution, if there be a surplus, that preferred receive more than par.

We regard it as clear under the contracts, that the holders of common stock are entitled to all of the annual profits after the payment of dividends of 4% to the preferred stock. Whatever doubt there may have existed upon the question must be regarded as removed by the practical construction acquiesced in by all interests for the period of ten years in which the common stock has received greater dividends than the preferred stock. If for any reason the Board of Directors has not declared all of the earnings in excess of 4% upon the preferred stock as dividends upon the common stock, why should the common stock be deprived of those earnings upon dissolution?

The Reading Company contends that there is no express preference or limitation of the preferred in the certificates in case of liquidation, and that therefore the preferred should share equally with the common. But the certificates are express in their limitations that the preferred may be redeemed at par and that it shall not receive profits "exceeding 4% per annum". The implication in case of distribution in liquidation is clear.

There is no case in the books which holds that preferred stockholders, expressly limited in their rights as they are in the instant case, are entitled to share equally with the common upon a dissolution.

The appellees' contention that upon dissolution the holders of preferred and common stock of the Reading Company share equally, rests upon *Birch* v. *Cropper* (*In re Bridgewater Navigation Co. Ltd.*), 14 A. C. 525, 1889)). Far from holding that upon dissolution preferred and common share equally, even where there is no express provision to the contrary, *Birch* v. *Cropper* held that upon dissolution, preferred and common share equally in increments of capital *only*, and upon the decision in that case, the Court of Appeal in *In re Bridge-*

water Navigation Co., L. R. (1891) 2 Ch. D. 317 (the very same case) held that before equal distribution is made to common and preferred stock, the annual profits of previous years represented not by separate funds or by property in specie but intermingled with all of the assets of the corporation, must be distributed wholly to the common stock.

We can even rest upon the decision of the Court of Appeal in *In re Bridgewater Navigation Co.* and the decision of the House of Lords in the same case, although we do not regard them as at all applicable to the situation presented here. The result of these decisions, when applied to the situation of the Reading Company is, that all annual profits which, if distributed, would have gone to the common stock in previous years, should be paid over to them prior to an equal distribution to the preferred and the common stock.

An analysis of those cases shows that they support our contentions and not those of the appellees.

In *In re Bridgewater Navigation Co. Ltd.*, 14 A. C. 525, the following was the situation. A fortuitous sale of the property of the corporation resulted in a large profit and the company *was actually wound up*. There were certain items which appeared upon the balance sheet as liabilities; these items were: a Canal and River Improvement Fund, an Insurance Fund, and a Depreciation of Steamers Fund.

These represented earnings of previous years which had not been distributed to the common stockholders who were entitled to receive them if they had been distributed.* The items were not represented by any specific property nor any ear-marked funds. The question which was submitted to the House of Lords was held to be:** After returning to the stockholders their contributions to the capital of the Company and subject to the adjustment of the

* L. R. 2 Ch. 317, 320, 326.

** L. R. 2 Ch. 317, 325, 330, 331.

rights of the preferred and common stockholders in the items which represented the earnings of previous years, what should be the rule governing the distribution of the remainder of the proceeds of sale of the property of the corporation?* That remainder obviously represented the increment in value resulting from the fortuitous and profitable sale. As to that part of the proceeds of sale, the House of Lords held the distribution should be made to preferred and common, share and share alike.** But as to any items which represented the earnings of previous years, not theretofore distributed, the Court of Appeal, in *In re Bridgewater Navigation Co.* L. R. (1891), 2 Ch. D. 317, held that funds equal to those items be distributed to common stockholders alone.

The Court of Appeal (Lindley, *L. J.*) said:

> (p. 329): "The problem is no longer what is to be done in the way of dividing the profits of a going concern; the problem now is, how much of the whole assets of the company belongs to one class of shareholders, and how much to another; and if it appears that some of those assets consist of undrawn profits of one of those classes, such undrawn profits ought to be distributed amongst the members of that class, unless some sufficient reason to the contrary can be shown."

The items which were dealt with by the Court of Appeal represented items similar to the surplus of the Reading Company. Upon any dissolution, such annual profits as would have been distributed to the holders of common stock alone if distribution had been made, must be paid to the holders of the common stock prior to any equal distribution to preferred and common.

There is no contention that there has been any increment in the value of the original investment of the Reading Company other than through accumulation of earnings. The surplus of the Reading Company as well as the

*See also North, *J.*, in *In re Bridgewater Navigation Company*, L. R. (1891) 1 Ch. 155, 164, 165.

**See L. R. (1891) 2 Ch. 317, 325, 330, 331.

surplus of the Coal Company and the Railway Company are the result of the annual accumulation of earnings (R. 62, 259).

In none of the cases in the Courts of this country cited by the Reading Company or the other appellees was the court called upon to determine the rights of preferred and common stockholders, in assets sufficient in amount to leave a surplus after payment of the par value of the preferred and common stock.

Lloyd v. *Penna. Vehicle Co.*, 75 N. J. Eq. 263, merely held that preferred stock was not entitled to a preference out of assets where no preference was expressly given. Nothing that the court said in its dictum can be interpreted to mean anything other than upon distribution, the holders of common stock are entitled to the annual profits remaining after payment of the preferred dividends to holders of preferred stock, and that the remainder of the assets should be distributed equally between preferred and common stock which appears very clear from the interpretation of the Court of the decision of the House of Lords in *re Bridgewater Navigation Co., Ltd.*, 14 A. C. 525, of which the court said:

> (p. 268): "The common stockholders insisted that the whole of this surplus was profits, and that, as they were entitled to all of the profits after paying the 5 per cent to the preferred stockholders, they were entitled to the whole of the fund. The court, however, held that this position was untenable, and that the rule contended for by the common stockholders applied only to annual profits, and not to the large profits arising from the sale of the property of the corporation. In this respect the decree was affirmed by the House of Lords, but it was there held that the surplus should be divided among the stockholders in proportion to the number of shares held by each, and not in proportion to the amount contributed by each."

Jones v. *Concord & Montreal Railroad Co.*, 67 N. H. 119, merely involved the issuance of additional stock by a corporation, not a distribution of assets upon dissolution.

The question as to the rights of the preferred and common upon dissolution we respectfully submit cannot be affected by the *ex parte* statement of the Reading Company made to the New York Stock Exchange for the listing of the stock of the Reading Company, eight years after the re-organization of the Reading Company and the authorization and issuance of the preferred and common stock. The holders of common stock were not parties to that declaration and have never acquiesced therein and no conduct has been alleged from which any acquiescence can be even implied. The rights of the preferred stockholders as against the holders of common, cannot be established, by *ex parte* statements made by the Reading Company in the listing application to a private exchange whose records are not public records and whose activities are not subject to any public regulation.

III.

Assuming, *arguendo*, that the preferred stock shares equally with the common on dissolution, and further that a merger in this case would involve a dissolution, nevertheless the preferred stockholders are not entitled to share in the distribution of stock of the New Coal Company.

The rights of shareholders *inter sese* are not the same on a dissolution which is incident to a merger or consolidation, as on a complete dissolution and winding up of the corporation's business (*supra*, pp. 9-13).

The truth is that the doctrine of those cases which hold (in construing certificates of stock differing from those of the instant case) that upon a *real* dissolution and winding-up, the preferred and common share alike, is based upon the essential feature that the corporation no longer continues in an enterprise for profit and that the relationship between the stockholders as stockholders

is terminated. If through any device of reorganization, whether it be merger or consolidation, and whether a dissolution of the reorganized companies be involved or not, the former stockholders continue to participate in a going enterprise run for profit, the principles involved in *real* dissolution have no application.

This is the doctrine of the reorganization cases. See *Northern Pacific R. R.* v. *Boyd*, 228 U. S. 482; *Hale* v. *Cheshire Railroad Company*, 161 Mass. 443 (*supra*, p. 11); *Mayfield* v. *Alton Ry. G. & E. Co.*, 100 Ill. App. 614 (*supra*, pp. 9-11); *Southern Pacific R. R. Co.* v. *Bogert*, 250 U. S. 483; *Geddes* v. *Anaconda Copper Mining Co.*, 254 U. S. 590; *Jones* v. *Missouri Edison Electric Co.*, 144 Fed. 765.

Thus in the *Bogert* case, 250 U. S. 483, the Court protected the interests of stockholders of corporations which had been reorganized. In the *Geddes* case, 254 U. S. 590, the Court protected a minority stockholder against an unlawful sale even though dissolution of the corporation was involved in the plan of the majority.

As was said by the Court in *Jones* v. *Missouri Edison Elec. Co.*, 144 Fed. 765, the duty of the majority to conduct themselves as trustees for the minority holds both in a sale of the property of the corporation and in a consolidation (p. 771).

How easy it would be for majority to oppress minority stockholders by forming a new corporation in which the majority would participate to the disadvantage of the minority, if they could support such a plan by the device of only technical dissolution involved in a merger or consolidation!

The essence of the present case is the distribution, in one form or another, of extremely valuable rights of the corporation to preferred stockholders who continue as such in the going concern operated for profit, and whose certificates provide that distribution to them shall be limited to 4% per annum.

IV.

The Memorandum Filed on Behalf of the Government.

It must be conceded that the question raised by the appeal as the Government correctly says is not one

> "in which the United States has a direct or special interest."

It does not appear from the memorandum that the Government is in any wise prejudiced by a modification of the decree which contemplates justice to the common stockholders. It is quite difficult to conceive how the Government can at all be interested in whether certificates of interest in the stock of the New Coal Company are given wholly to the common stockholders or distributed equally to preferred and common.

The question involved on this appeal is not whether discretion was properly exercised by the Court below. The Court below might have approved a plan for a distribution of stock to shareholders entitled thereto (Main Brief, p. 21). Were there a *real* sale in this case, it might well be argued that any discretion of the Court as to the persons who should purchase the stock of the New Coal Company should not be interfered with. But the division of the stock of the New Coal Company or certificates of interest therein, to holders of preferred and common, share and share alike, was not a matter which involved discretion as to the manner in which the mandate of this Court should be carried out. This Court has never approved, and the courts have never enforced, any plan for a dissolution of a combination in restraint of trade which has impaired the relative rights of preferred and common stockholders. And the Court below did not intend to impair such rights. The division to common and preferred was approved on the theory that it did not prejudice the legal rights of the classes of stockholders. It was not an exercise of discretion, but an adjudication of rights.

The controlling factors enumerated by this Court in *United States* v. *American Tobacco Co.*, 221 U. S. 106, 185, to which the Government makes reference, do not require that certificates of interest in the stock of the New Coal Company shall be distributed equally to preferred and common, because

1. a complete and efficacious effect to the prohibitions of the Anti-Trust Act is given, irrespective of the distribution as between preferred and common; 2. the general public is not affected by the question of whether or not the distribution is made to holders of preferred or common, or to either, but the public interests are prejudiced by permitting injustice to be done under the guise of a decree of this Court; 3. upon the question of a proper regard for the interests of private property which have become vested in many persons, the Court below determined that the legal rights were not impaired by the Plan, and that presents the question on this appeal.

The point is made that the Plan should be approved, notwithstanding an injury to the legal rights of the common stockholders, because the result has proved satisfactory to the vast majority of Reading stockholders. The New York Central Railroad Company and the Baltimore & Ohio Railroad Company unquestionably approve the Plan. Eliminating the New York Central and the Baltimore & Ohio, it appears that of the preferred stock held by independent holders, 39% have appeared to approve of the Plan, and that of the holders of common stock (other than the New York Central and the Baltimore & Ohio) 41% have appeared to oppose the Plan. No inference can be drawn from the fact that 41% having appeared to oppose the Plan, that the other 59% approve of it. It may with equal cogency be argued that the holders of 61% of the preferred stock who have not appeared are in no way interested in the question of how the "rights" are distributed as between the preferred and common

stock. The fact is that there is a large floating supply of stock of the Reading Company preferred and common, and it is unnecessary where representatives of so substantial a part of the common stock appear to object to a plan, that the other holders personally be represented. This Court has given effective protection to a minority, less substantial in amount than is represented by the appellants.

With respect to the holder of 100,000 shares of common stock who at this time approves the Plan, it may well be said that he still manifests his approval, although he at one time objected to the Plan and authorized the Prosser Committee to appear for him (R. 150).

It is further said in the memorandum filed on behalf of the Government that relief should not be granted to the common stockholders because of any "technical" right as between different classes of stockholders.

We respectfully submit that the characterization of the legal rights of the common stockholders as "technical" must proceed from a failure to appreciate the facts of the case. (See Main brief, pp. 5-17.)

Furthermore in addition to the stock of the Coal Company, the Reading Company must dispose of the stock of the Jersey Central in which the Reading Company has an equity of $26,831,800 (R. 123—Lehigh-Wilkes-Barre Coal Company and Jersey Central). It must also dispose of the stock of the Reading Iron Company in which the Reading Company has an equity (R. 123) of $22,791,500. (Constitution of Penna., 1874, Article 17, Section 5, R. 18.)

If the Court in this case will permit the distribution of the surplus of the Reading Company to preferred and common share and share alike, similar distribution will be made with respect to the proceeds of the stock of the Jersey Central and of the stock of the Reading Iron Company. Nor will the matter end there. The Reading Company may at some time conclude that holding the $25,000,000 of new 4% Mortgage bonds of the Coal Com-

pany, may involve legal difficulties and conclude that such bonds should be distributed. Yet the surplus of all the companies combined is sufficiently large to enable all such distributions to be made out of surplus without in any wise impairing the capital of the Reading Company.

Or, if the argument of the Reading Company is sound, the Reading Company may convey its surplus to a new corporation and distribute its stock equally to preferred and common. The result of such conduct will be ultimately that the preferred stock will retain its right to 4% non-cumulative preferred dividends, and will acquire in addition annual dividends equal to that of the common stock. The reduction of surplus is an injury to the common stock; it leaves the preferred stock and its right to dividends unimpaired.

If the distribution in this case is sustained, the Reading Company controlled by the preferred stockholders may refuse to pay dividends on the common stock or dividends of only 4% per annum, allow the surplus (representing earnings which if declared as dividends go to the holders of common stock alone) to accumulate, and then when some pretext arises for such action, dispose of assets equal in value to the surplus and distribute the same alike to preferred and common.

We respectfully submit that the characterization of the rights of common stockholders as "technical" in this case, can proceed only upon a failure properly to measure the injury which the Plan approved by the Court below inflicts upon the holders of common stock.

Respectfully submitted,

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ALFRED A. COOK,
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APPENDIX A.

(From brief of Reading Company submitted to the Court below.)

POINT 1. The transaction is a sale of the interest of the Reading Company in the coal property, not a dividend. The fact that the selling price is less than the book value of its investment in the coal property on the books of the Reading Company, necessitating a charge against surplus, does not alter its nature.

It is the real nature of the transaction and the character of the asset disposed of, not the effect of such disposition on the books of the company, which determine the rights in respect of such disposition.

United States v. *Union Pacific Railroad Company,* 226 U. S. 61 (1912).

United States Trust Company of New York v. *Heye,* 181 A. D. (N. Y.) 544; 224 N. Y. 242 (1918).

It seems advisable to set out in some detail the facts in connection with the dissolution of the combination between the Union Pacific Railroad Company and the Southern Pacific Company and the dissolution of the Standard Oil Trust, in connection with which these cases arose.

A. The Union Pacific Case.

(*a*) The Union Pacific Railroad Company is a corporation of the State of Utah, having both preferred and common stock. Prior to 1908, the Union Pacific owned all the stock of the Oregon Short Line Railroad Company, which in turn owned $126,650,000, par amount, of the stock of the Southern Pacific Company or about 46% of the outstanding stock. In that year, the Government brought suit against the Union Pacific, the Oregon Short

Line and other defendants, alleging a combination in restraint of trade in violation of the Sherman Act. In 1912 the Supreme Court held that an illegal combination existed, and directed that a plan providing for the disposition of the Southern Pacific stock should be filed with the District Court for the District of Utah. *United States* v. *Union Pacific Railroad Company, supra.*

Thereafter, various plans were submitted to the District Court and on June 30, 1913, that Court entered a decree approving the sale of $38,292,400, par value, of the Southern Pacific stock to the Pennsylvania Railroad Company in exchange for $42,547,200, par value, of the stock of The Baltimore and Ohio Railroad Company, half preferred and half common, and directing that the remaining shares (883,576) should be transferred to Central Trust Company of New York, as Trustee, and that the right to subscribe to certificates of interest representing such shares should be offered to all stockholders of the Union Pacific, common and preferred, *pro rata,* at such price as the Union Pacific should determine.

Pursuant to this decree the Union Pacific offered its stockholders, preferred and common, the right to subscribe ratably to such certificates of interest at $88 a share, and accrued dividends. At the time of this distribution the Southern Pacific had a surplus of more than $60,000,000.

(*b*) Thereafter the Union Pacific declared an extraordinary dividend on its common stock consisting of the following amounts on each share: 1. three dollars in cash; 2. twelve dollars, par value, of preferred stock of the Baltimore and Ohio; 3. twenty-two and a half dollars, par value, of the common stock of the Baltimore and Ohio. The regular dividend on the common stock was at the same time reduced from 10% to 8%, the reduction being the exact equivalent of the income value of the extraordinary dividend.

The Union Pacific stock certificates provide:

"The holders of Preferred Stock shall be entitled, in preference and priority over the Common Stock of said Company to dividends in each and every fiscal year at such rate not exceeding 4 per cent. per annum, payable out of net profits, as shall be declared by the Board of Directors.

Such dividends are non-cumulative *and such Preferred Stock is entitled to no other or further share of the profits.*"

A preferred stockholder sought to enjoin the payment of this dividend to the common stock exclusively, but it was held that this was a dividend declared out of profits, and that, as the preferred stockholders, having received 4% dividends, were entitled to no other or further share of the profits, the dividend was properly declared to the common stockholders.

The Equitable Life Assurance Society of the United States v. *Union Pacific Railroad Company*, 162 A. D. (N. Y.) 81, 212 N. Y. 360 (1914).

B. The Standard Oil Dissolution.

Prior to 1911 the Standard Oil Company of New Jersey owned the stock of thirty-three subsidiary companies. In that year, on the suit of the Federal Government, a decree was entered in the United States Circuit Court enjoining the continuance of this unlawful combination and permitting the Standard Oil Company to distribute the stocks of its subsidiary companies among its own stockholders. Thereupon the directors resolved that the stocks of subsidiary companies be distributed among the stockholders of the parent company and that the book value of the stocks distributed be charged to "Reserve Profits." The rights arising out of this distribution were considered by the New York Courts in *United States Trust Company of New York* v. *Heye, supra.*

This case involved the rights of a life tenant and remainderman under a trust created in 1899. Most of the stocks distributed had originally formed part of the trust estate, and had been exchanged for stock of the Standard Oil Company of New Jersey. The book value of the Standard Oil stock, December 31, 1899, was $202.32 per share. Before the distribution of December 1, 1911, accumulated earnings had brought the value up to $566.67, and after the distribution the book value was $281.72 per share. Therefore, the "Reserved Profits" account against which the distribution was charged consisted largely of earnings accumulated since the creation of the trust. The subsidiaries whose stock was distributed also had large accumulated earnings. The Court said that earnings accumulated since the creation of the trust went to the life tenant, but nevertheless held that the remainderman was entitled to all the stock so distributed except that which had been acually acquired by the Standard Oil Company out of earnings accumulated since the creation of the trust.

C. Application of Foregoing Cases to Point 1.

The difference between the rights of stockholders in case of a sale and their rights in case of a dividend is shown by the two cases arising out of the Union Pacific dissolution proceedings. In the Baltimore and Ohio stock distribution case, *The Equitable Life Assurance Society of the United States* v. *Union Pacific Railroad Company, supra,* the court held that the Baltimore and Ohio stock distributed (a part of which had been received in exchange for Southern Pacific stock) represented profits of the Union Pacific, and accordingly, when distributed by way of dividend, was properly given to the common stockholders exclusively. In the dissolution proceedings, however, when the transaction in question was a *sale,* the

Court directed that the remaining Southern Pacific stock be sold to preferred and common stockholders, *pro rata*.

In the *Heye* case (Standard Oil dissolution) the Board of Directors had resolved that the book value of the stocks distributed should be charged to "Reserve Profits", which consisted in large part of earnings accumulated since the creation of the trust. (See p. 4.) The Court stated the rule that earnings accumulated since the creation of the trust belonged to the life tenants, but nevertheless held that the remainderman was entitled to all the stocks which had originally formed part of the principal of the trust in spite of the fact that the distribution reduced the amount of surplus shown on the books and available for distribution in dividends to the life tenant.

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IN THE

Supreme Court of the United States

October Term, 1921, Nos. 609, 610

CONTINENTAL INSURANCE COMPANY, *et al., Appellants,*

vs.

READING COMPANY, *et al., Appellees.*

SEWARD PROSSER, *et al.,* as a Committee, etc., *Appellants,*

vs.

READING COMPANY, *et al., Appellees.*

ON REARGUMENT

Brief for Adrian Iselin, *et al.,* a Committee Representing Preferred Stockholders, *Appellees*

We shall first analyze the Plan and Decree and then proceed to a discussion of the questions assigned by the Court for consideration.

Analysis of the Plan and Decree.

(a) Considerations Exchanged by the Reading Company and the New Coal Company (R. 275-276).

The Reading Company

(1) transfers all its interest in the stock of the *old* Coal Company to the *new* Coal Company;

(2) agrees to save the *new* Coal Company and the stock of the *old* Coal Company which it transfers, harmless from the lien of the general mortgage;

(3) agrees to obtain the release of the stock of the *old* Coal Company from the lien of the general mortgage at or before the maturity of such mortgage;

(4) agrees at that time to obtain the delivery of the stock of the *old* Coal Company to the *new* Coal Company.

In consideration of the foregoing, the *new* Coal Company

(1) pays the Reading Company $5,600,000, and

(2) agrees to issue certificates of interest in its stock to the stockholders of the Reading Company, these certificates to be exchangeable for stock in the *new* Coal Company when accompanied by a suitable affidavit and upon the payment provided for.

The payment may be explained as follows:

The Reading Company has outstanding $70,000,000 par value of first and second preferred stock, and a like amount par value of common stock, a total of $140,000,000 or 2,800,000 shares of stock, as all shares have a par value of $50.

The sum to be paid, to wit, $5,600,000, divided by the number of shares outstanding of the Reading Company, to wit, 2,800,000, equals $2.00 per share.

The *new* Coal Company is to issue 1,400,000 shares of stock without par value. It is obvious that as this no par value stock is to be sold by the new Coal Company to the stockholders of the Reading Company, preferred and common, share and share alike, each holder of one share of the Reading Company will be entitled to receive one-half a share of stock of the new Coal Company on payment of $2.00. In other words, one share of stock of the new Coal Company will cost $4.00, but in order to purchase one share, the purchaser will have to hold two shares of the Reading Company (R. 275).

(b) Considerations Exchanged by the Reading Company and the Old Coal Company (R. 275).

The Reading Company

(1) assumes the entire obligation to pay $96,524,000 general mortgage 4 per cent. bonds due January 1, 1997;

(2) agrees to save the *old* Coal Company and its property harmless therefrom;

(3) agrees that at or before maturity of the general mortgage bonds, it will obtain the release of the property of the *old* Coal Company from the lien of the general mortgage and the discharge of the *old* Coal Company from liability on the general mortgage bonds;

(4) agrees to execute to the *old* Coal Company a general release of all claims and liabilities. This will include the claim of approximately $70,000,000 now carried on the books of the Reading Company as an asset and on the books of the *old* Coal Company as a liability.

The *old* Coal Company

(1) pays to the Reading Company (a) $10,000,000 in cash or current assets at market value, and (b) $25,000,000 in 4 per cent. mortgage bonds of the *old* Coal Company;

(2) agrees to give the Reading Company a general release of all claims and liabilities.

(c) Provisions Which Safeguard the Issue of the Stock of the New Coal Company and Make Impossible the Recreation of a Similar Combination.

The stock of the new Coal Company in the first instance is to be issued to trustees appointed by the court (R. 292); the trustees are to issue certificates of interest

which shall be offered for subscription to the stockholders of the Reading Company, preferred and common, share and share alike (R. 292). A copy of the certificate of interest is printed in the record, pages 302 and 303.

A stockholder of the Reading Company may obtain delivery of a certificate of interest upon payment in full of the subscription price, to wit, $2.00 per share of Reading Company or $4.00 per share of the new Coal Company.

The certificate of interest (R. 302) states that the trustees have received and hold for , or assigns shares of the capital stock of the new Coal Company, subject to the terms of the decree entered in this cause, to which reference is made, and "to which decree the holder of this certificate assents by acceptance hereof." The certificate of interest further states that the owner of thereof is entitled to receive shares of stock of the new Coal Company, upon filing with the trustees an affidavit that he does not own any shares of the capital stock of the Reading Company and is not acting for stockholders of the Reading Company or in concert with other persons for the control of the new Company in the interest of the Reading Company (R. 303).

Neither the Reading Company nor any corporation controlled by it nor any person acting in its interest may acquire by purchase or otherwise any of the certificates of interest issued by the trustees (R. 292).

A registered owner of such a certificate of interest which, as stated, will be issued by the trustees appointed by the court, may obtain an exchange of the certificate for an equivalent number of shares of the *new* Coal Company when he files with the trustees a properly executed affidavit in one of the forms provided in the decree. These forms are printed in the record, pages 305 to 308.

The affidavit which the applicant must execute as a condition of exchanging the certificate of interest for

shares of stock in the new Coal Company, declares that the applicant is a *bona fide* owner of the certificate of interest; that he does not own any shares of the capital stock of the Reading Company and he is not acting for or on behalf of any stockholder of the Reading Company or in concert or agreement with any other person, firm or corporation for the control of the Reading Company, but is acting in good faith in his own behalf (R. 305).

(d) Reports to the Attorney-General.

The decree requires the trustees to report monthly to the Attorney-General the amount of certificates of interest surrendered for exchange for shares of the new Coal Company. At any time, upon the request of the Attorney-General, the trustees shall furnish him with any additional information which he may require relative to the carrying out of the decree (R. 294).

I.

The First Question.

The first question, which we understand the Court desires to be considered, is:

> "Whether the disposition by the Reading Company of the stock of the Philadelphia & Reading Coal & Iron Company, contemplated and ordered in the decree of the District Court, will establish such entire independence between the Reading Company, present and prospective, and the Philadelphia & Reading Coal & Iron Company and the new company to be organized, as is required by the opinion and judgment of this court."

The decree on the mandate directed the defendants to submit a plan for dissolution of the unlawful combination between the five companies existing and maintained

through the Reading Company, with such provisions for the disposition of the shares of stock and bonds and other property of the various companies held by the Reading Company as may be necessary to establish the entire independence from that Company and from each other of the Railway Company, the Coal Company, etc. (R. 36-37).

The modified plan will be found in the record, pages 274 to 277, and the decree will be found at pages 287 to 312. It is necessary to examine each of the references just given, as the plan was not reprinted in the decree although it forms a part of the decree (R. 290).

We shall assume that the plan has been put into effect, and shall describe what we understand to be the condition produced thereby.

(a) The Companies as they will be after the Plan has been completed.

The Reading Company, the holding company, has passed out of existence. It has merged with the Philadelphia and Reading Railway Company and surrendered those peculiar powers which it held under its special charter and which were inappropriate for a railroad corporation of Pennsylvania, accepted the Pennsylvania Constitution of 1874 and has received new letters patent from the Governor creating it a railroad corporation subject to State and Federal authorities as a common carrier, no longer possessing any extraordinary powers (R. 277). Penna. Laws 1909 (P. L. 408). As we pointed out in our original brief (pp. 28 *et seq.)* filed herein, in effect the pre-existing Reading Company has been terminated, its affairs liquidated, and an entirely new corporation created to own and operate the railroad.

A new Coal Company also has been formed and to that company the Reading Company has transferred the stock of the old Coal Company, subject, however, to the lien of the existing general mortgage (R. 291).

The new Coal Company has obtained the right to vote on the stock of the old Coal Company (R. 291). The old Reading Company has ceased to exist and the new Reading (Railway) Company can never obtain the right to vote the stock of the old Coal Company. The Reading Company also has executed and delivered to the trustee of the general mortgage an irrevocable order directing it to deliver to the new Coal Company a suitable power of attorney to vote the stock of the old Coal Company. The trustee has executed and delivered such proxy or power of attorney to the new Coal Company. This proxy can be terminated only by default under and foreclosure of the general mortgage. In the event of such default, and sale under foreclosure the coal properties and the railway cannot be acquired by the same interest, because the decree expressly prohibits this (R. 298, par. 6).

While the new Coal Company is in possession of the right to vote the stock of the old Coal Company, it is enjoined from voting the same in such a way as to bring about any new relations between the Railway Company and the old Coal Company of the character complained of (R. 276; R. 295 #J).

(b) The Lien of the General Mortgage Is Unimportant.

The capital stock and the coal properties of the old Coal Company remain subject to the lien of the general mortgage which was executed in 1896 by the Reading Company and the old Coal Company. The stock certificates are held by the trustee of that mortgage which covers also certain railway properties.

The new Reading (Railway) Company has assumed all liability for the general mortgage bonds and has agreed to save the old Coal Company and its property harmless therefrom (R. 274, par. 1). The new Reading Company also has agreed that when the general mortgage bonds mature, January 1, 1997, or sooner, it will obtain the

release of the old Coal Company's *property* from the lien of the general mortgage and will, also, obtain the discharge of the old Coal Company from liability on the general mortgage bonds (R. 275, par. 4). The old Reading Company and the new Reading (Railway) Company also has agreed to protect the stock of the old Coal Company from the lien of the general mortgage, and furthermore has agreed to obtain the release of the *stock* of the old Coal Company from the lien of the general mortgage at its maturity or sooner, and to procure delivery of the stock to the new Coal Company (R. 275, par. 5).

The injunctive provisions of the decree have made it impossible for the coal properties and the railroad properties to be brought together under a single ownership or control, in the event of default and sale under the general mortgage. For the decree provides (R. 298, par. 6). that in the event of default under the general mortgage, the trustee shall exercise the right to vote the stock of the old Coal Company in such a way as not to bring about unity of management between the old Coal Company and the Reading Company, now the Railway Company. The court also has directed that in the event of a sale under the general mortgage of the stock or coal properties of the old Coal Company, the trustee shall dispose of such stock and properties separately from the properties of the Reading Company—the Railway Company—and to different interests (R. 298, par. 6).

(c) Additional Injunctive Provisions to Insure a Permanent Separation of the Coal Properties and the Railroad.

The names of the officers and directors of the new Coal Company have been submitted to the court for approval (R. 291, par. 3a).

No officer or director of the new Coal Company may be an officer or director of the new Reading Company.

The new Coal Company has been obliged to enter its appearance in this cause by counsel and to submit itself to the jurisdiction of the court for all purposes of this cause (R. 291). This appearance was required of it before the transfer of the interest in the stock of the old Coal Company.

The new Coal Company, pursuant to the decree, has become a party defendant to this cause and subject to the provisions of this decree (R. 291).

The new Coal Company and its officers and directors have been enjoined from exercising the voting power in the stock of the old Company so as to form a combination between the old Coal Company and the new Reading (Railway) Company—such as has been adjudged unlawful (R. 295J).

Never again can the company owning the coal mining enterprise and the company owning the railroads enter into close corporate relations. The decree has provided against this, for it has permanently enjoined the old Coal Company from issuing to the new Reading Company and the latter company from receiving any stock, bonds or other evidence of corporate indebtedness of the old Coal Company in addition to the $25,000,000 of 4 per cent. bonds referred to above (R. 297, par. 7).

Furthermore, the Reading Company, now the Railway Company, can never acquire control of the *new* Coal Company or purchase the stock of that company. This is expressly inhibited by the decree.

For Paragraph "K" of Section 3 (R. 295) provides:

> "The Reading Company and all persons acting for and in its interest are hereby *perpetually* enjoined from acquiring, receiving, holding, voting or in any manner acting as the owner of any of the shares of the capital stock of the new corporation."

How can there be a clearer prohibition against the Railway Company ever acquiring any interest in the *new* Coal Company?

During the period allowed for the conversion of the certificates of interest into stock of the new Coal Company, no present stockholder of the Reading Company may be a purchaser of stock of the new corporation if still a stockholder of the Reading Company. [Paragraph "I," Section 3 (R. 295).] That is to say, a stockholder of the Reading Company may not during this period purchase on the market stock of the new Coal Company as long as he remains a stockholder of the Reading Company.

In order to ensure enforcement of this provision, it is provided that

> "The Attorney-General of the United States shall have access to the stock transfer books of the Reading Company and the new corporation for the purpose of enabling him to enforce compliance by such stockholders with this provision of this decree" (R. 295, par. I).

Nor may the *new* Coal Company ever acquire stock of the new Reading Company. This is prevented by Paragraph "K," Section 3 (R. 295), which "*perpetually* enjoins the new corporation and all persons acting for or in its interest from acquiring, receiving, holding, voting, or in any manner acting as the owner of any of the shares of the capital stock of the Reading Company."

II.

The Second Question.

The second question suggested by the Court is as follows:

> "2. Whether the general mortgage having been executed, and the bonds secured by it issued, as a part of the process of forming the combination held to be unlawful, there is any legal or practical difficulty in providing, by appropriate modification of the decree, for sale of the Coal Company's stock, owned by the Reading Company, free from the lien of that mortgage, and from the lien of the contemplated new mortgage."

It will be noted that the foregoing question relates to freeing from the mortgage the *stock* of the old Coal Company, and makes no reference to the *properties* of the old Coal Company. The general mortgage of 1896 of the Reading Company (to which the old Coal Company was also a party) covers all the coal properties as well as the stock of the old Coal Company.

The record does not contain a copy of the general mortgage. A sufficient description of it, however, will be found on page 217 and also at pages 239 and 240; the first reference being to the plan of reorganization and the second being contained in the application to list on the New York Stock Exchange.

(a) As to the lien of the contemplated new mortgage.

The question is whether there is any legal or practical difficulty in providing for the sale of the Coal Company's stock free from the lien of the contemplated new mortgage. The statement of this question indicates a misapprehension. The stock of the *old* Coal Company will not be subject to the lien of the contemplated new mort-

gage. It is the *old* Coal Company, not the *new* Coal Company which is to give $25,000,000 of mortgage bonds to the Reading Company when the latter becomes a railroad company. If the contemplated new mortgage were being executed by the *new* Coal Company, doubtless such a mortgage would have to rest upon the interest in the stock of the *old* Coal Company possessed by the *new* Coal Company. But, as stated above, the plan provides for the mortgage to be executed by the *old* Coal Company, which, of course, can be carried out without subjecting the stock of the *old* Coal Company—that is, the stock of the obligor under the new mortgage—to the mortgage.

(b) There is no danger of the unlawful combination being recreated in the event of a default on the new $25,000,000 mortgage or default on the general mortgage.

It is the *old* Coal Company, not the *new* Coal Company which gives $25,000,000 of mortgage bonds to the Railway Company. This new mortgage matures January 1, 1997, the same day as the general mortgage matures.

It is to be remembered that an essential feature of the plan is the provision for the consolidation of the Reading Company and Railway Company, and the surrender by the Reading Company of its special powers, the Reading Company becoming a railroad corporation. Therefore, even if there should be a default on the new mortgage, January 1, 1997, the beneficiary of the mortgage, namely, the Reading Company, will not be able to purchase the coal properties of the old Coal Company on a sale under the new mortgage. This would be forbidden by the laws of Pennsylvania, which prevent a railroad company owning coal properties.

We think that the provisions of the decree elsewhere analyzed are sufficient to prevent the recreation of the combination in the event of any such sale. But if the

decree is not broad enough to accomplish that result, it *is* accomplished by the laws and Constitution of Pennsylvania (R. 18).

On January 1, 1997, when the general mortgage and the proposed new mortgage mature, the situation will be as follows:

The Central Union Trust Company, trustee of the general mortgage, will hold as security for the payment of the general mortgage debt the following:

1. The promise of the Reading Company to pay, the Reading Company having become a railway company.

2. The promise of the *old* Coal Company to pay.

3. The railroad properties and equipment and other property of the Reading Company.

4. The coal properties of the *old* Coal Company.

5. The capital stock of the *old* Coal Company.

But the Reading Company must first exhaust its resources to the last dollar to pay the general mortgage bonds before the old Coal Company can be called upon by the trustee under its secondary obligation. The stock of the old Coal Company no longer belongs to the Reading Company, so it cannot use that stock in part payment of its obligation. It has no control of the coal properties and cannot use those either.

The Reading Company will hold, however, a claim against the old Coal Company for $25,000,000 maturing on that day.

The Reading Company has promised the *new* Coal Company that it will on that day or earlier deliver to the *new* Coal Company the stock of the *old* Coal Company free from the lien of the general mortgage and, also,

that it will release from the general mortgage the coal properties of the *old* Coal Company.

Suppose the old Coal Company defaults to the Reading Company; that is to say, is unable to pay the Reading Company $25,000,000 on January 1, 1997. If by reason of that default the Reading Company is unable to meet its obligation under the general mortgage, the trustee under the general mortgage may be obliged to sell the coal properties held thereunder, but it has been elsewhere noted that in the event of such sale by foreclosure under the general mortgage, the decree prevents and prohibits the coal properties and the railroad coming into a single control (R. 298, par. 6). Therefore, at this point, we have only to consider whether a default by the old Coal Company under the new mortgage for $25,000,000 can, by any possibility, result in a recreation of the illegal combination. As we have noted above, the Reading Company has become merged with the Railway Company and has only the powers of a railway company. Therefore, under the laws and Constitution of Pennsylvania, it has no power to acquire the coal properties of the Coal Company at a sale under the new mortgage.

(c) The Modifications in the Plan were agreed to by the Attorney General.

Under the plan as first drawn, and filed February 14, 1921, it was proposed to obtain a release of the coal property from the lien of the general mortgage, and to discharge the Coal Company from the liability on the general mortgage bonds, provided such release and discharge could be acquired by the payment by the Reading Company to the bondholders of a premium not exceeding 10 per cent. upon the par value of the outstanding general mortgage bonds (R. 41-42, par. 4). The issuing of new refunding and improvement mortgage bonds to the Reading Company was contemplated. These were to be ex-

changed for the general mortgage bonds which should agree to the plan.

The plan which the Reading Company filed February 14, 1921, contained this statement (R. 42, par. 5):

> "It is assumed that the Attorney-General will ask the court to direct the release of the stock of the Coal Company from the lien of the general mortgage on such terms as the court may fix."

The foregoing provision of the original plan was abandoned in the modified plan.

In the modified plan, which appears at pages 274 to 277 [and which is not reprinted in the decree, although it forms part of the decree (R. 290)], it is provided merely that

> "the Reading Company will agree with the Coal Company that *at or before the maturity of the general mortgage bonds,* it will obtain the release of the Coal Company's property from the lien of the general mortgage and the discharge of the Coal Company from liability on the general mortgage bonds."

Subsequently, on March 1, the United States filed a supplemental bill to make the Central Union Trust Company of New York a party to the cause (R. 48 *et seq).* The Government alleged that the Reading Company had pledged with the Trust Company as trustee the capital stock of the Coal Company, and that the Reading Company had presented a plan for the dissolution of the combination which provided for the release of the stock of the Coal Company from the lien of the general mortgage, and, also, for the release of all the property of the Coal Company from the lien of the mortgage, and the assumption of the entire obligation thereof by the Reading Company (R. 49). The answer of the Central Union Trust Company (R. 151-152) asserts that its only interest is as trustee; that all the bonds under the mortgage were

not delivered at the time of the execution of the mortgage, but bonds have been issued and delivered up to 1920 for the purposes prescribed in the mortgage; that the bonds are numerous and widely scattered and few of the owners thereof, if any, are in any way identified with the management of the properties of the Reading Company or its auxiliaries, and that such bondholders have not been parties to any conspiracy, and that it is not necessary that the mortgage or the lien thereof should in any wise be disturbed in order to fully carry out the mandate of the Supreme Court.

Three of the intervening petitioners below are Pennsylvania corporations who own general mortgage bonds, and they intervened as such (R. 144-147).

The petition of the Insurance Companies, appellants (R. 71), objected to disturbing the lien of the general mortgage upon the coal properties and the stock of the Coal Company. It was urged that a segregation of the coal and railway properties could be effected by providing in the decree for the making of such agreements with the trustee as would render impossible any common control of the coal and railway properties. Several suggestions were made as to the form of such a decree, which will be found on pages 71 and 72.

The supplemental petition and answer of the Reading Company enumerated the three questions concerning which it desired to learn the decision of the District Court, as follows (R. 183):

> "1. The question between the preferred and common stockholders.
>
> "2 Whether the Coal Company's stock should be held free from the lien of the mortgage.
>
> "3. Whether the Reading Company should offer a premium of 10 per cent. to the general mortgage bondholders for release of the Coal Company's property from the lien of the mortgage."

The answer said also (R. 183):

> *"Concerning questions '2' and '3,' the Reading Company expresses no opinion. The provisions of the plan involving the proceedings as to which these questions arise, were inserted primarily to satisfy the Government and this Honorable Court."*

The Reading Company asked that if the court should determine either or both of these proceedings to be unnecessary, it might have an opportunity to present a modified plan in the light of such determination (R. 184 and 185).

Questions "2" and "3" *(supra)*, enumerated in the petition of the Reading Company, were set down for argument with question "1" on May 2nd, by the order of the lower court, filed April 12, 1921 (R. 206).

Before the argument, however, the Reading Company and the Attorney-General agreed to certain modifications of the plan. Paragraph "Fourth," which as originally drawn (R. 41-42), provided that the Reading Company would obtain the release of the coal property from the lien of the general mortgage, was changed so as to read (R. 210):

> "The Reading Company will agree with the Coal Company that, *at or before maturity* of the general mortgage bonds, it will obtain the release of the Coal Company's property from the lien of the general mortgage, etc."

These modifications appear in the record, pages 210 to 212, and were signed as approved on behalf of the United States by Mr. Myers (R. 212).

The modifications agreed upon and filed at the same time changed Paragraph "Fifth" so as to read (R. 210):

> "If the court so orders, the Reading Company will, subject to the lien of the general mortgage, sell * * * its interest in and to the stock of the Coal Company, etc."

(d) Important Injunctive Provisions Were Added by the Modified Plan.

The Attorney-General had agreed that it was not necessary to secure the release of the stock of the old Coal Company from the lien of the general mortgage and was content with a transfer of the entire interest that the Reading Company had in the stock of the old Coal Company, subject to the lien of the mortgage.

It should be noted, however, that most important injunctive provisions were added to paragraph "Fifth" by the modified plan. These injunctive provisions prevent the recreation of the combination.

1. It was provided that there should be embodied in the final decree "a permanent injunction against the new corporation exercising its voting power on the stock of the Coal Company in such a way as to bring about any new relations between the Coal Company and the Reading Company of the character complained of in the present suit" (R. 270).

2. A provision was inserted to protect the Government in the event of a default under the general mortgage and a sale of either (a) the stock, or (b) the coal properties of the old Coal Company. This provision reads (R. 270):

> "The final decree may provide that if by reason of default on the general mortgage bonds, the trustee, the Central Union Trust Company, shall exercise the right to vote the stock of the Reading Coal Company, it shall so exercise that right as not to bring about unity of management between said Coal Company and Reading Company; and the final decree may further provide that, in the event the trustee at any time is obliged to sell the stock or properties of Reading Coal Company, it shall dispose of such stock and properties separately from the properties of the Reading Company and to different interests."

There was another modification as the Attorney-General agreed that the Paragraph numbered "7" of the plan might be omitted (R. 212). The omitted paragraph (R. p. 44) had provided for the execution by the Reading Company of a refunding and improvement mortgage and that bonds under such mortgage might be exchanged for bonds under the general mortgage, which latter bonds, however, were to be kept alive until the general mortgage was released.

As pointed out above, the court below had set for argument on May 2d, the three questions which the Reading Company had asked to have argued, but when the matter came on for hearing, counsel for the Reading Company and for the United States and, also, for the trustee under the general mortgage, and counsel for the three intervenors who held blocks of general mortgage bonds, stated that they had reached an agreement in respect of points "2" and "3" (R. 280). They explained to the court the modifications of the plan which they had agreed upon. The court asked that these modifications be submitted in writing. They were filed on May 12th (R. 210-212).

The modified plan appears in the record, pages 274 to 277. The paragraphs in italics on these pages are identical with the modifications of May 12th, and printed on pages 210 to 212. The complete plan is found in the decree, pages 287, *et seq.*, except that pages 274 to 277 must be added, these pages not having been reprinted in the decree in order to save space.

It will be noted that the Plan was prepared in consultation with the court below. Judge BUFFINGTON refers to this fact in his opinion (R. 278-279). He states that after the return of the mandate of the Supreme Court, the court called before it counsel for the United States and counsel for the Reading Company (R. 278), "and directed the latter in consultation with the former to for-

mulate a dissolution plan in conformity with the said mandate. In accordance with these directions and after consultation by all of said counsel from time to time with the court, a tentative plan was eventually drafted and placed on file in the clerk's office for the inspection of all parties concerned. Subsequently, the court gave a hearing to all parties who desired to be heard and signified its willingness to receive for consideration petitions to intervene. Numerous parties and representatives of various interests having thus been heard, and numerous briefs having been filed showing the views of the parties concerned, the Court was thereby placed in possession of such information as enabled it to determine what parties should be allowed to intervene, and, also, to formulate such questions, issues and objections to the proposed plan as would afford a basis for an enlightened and constructive discussion on the part of all parties of record" (R. 278-279). The court enumerates the questions which it set for argument on May 2, 1921, by its order of April 12, 1921, in which order it directed that all parties who desired to be heard should file briefs on April 30, 1921, containing in substance their proposed arguments.

The court continues (R. 279):

> "Having thus in advance the advantage of the proposed arguments, the Court found on the day set for argument that, due to a modification of the plan agreed to by the Attorney-General of the United States, the counsel for the Reading Company and counsel representing certain holders of bonds secured by the general mortgage of the Reading Company, substantially all of the above questions were disposed of save those arising under Subdivision 'B' of the first question."

Subdivision "B" referred to the controversy between the different classes of stockholders.

III.
The Third Question.

The third question for consideration on the re-argument is:

> "Whether compliance with the decree will confer on any one class of stockholders of the Reading Company any benefit, to the prejudice of any other class of stockholders."

In the brief filed on the first argument on behalf of Adrian Iselin and others representing preferred stockholders, we discussed the authorities at some length. This subject is also considered in the brief of the Reading Company filed on the re-argument, pages 57 to 59, inclusive.

In our former brief we pointed out:

That the distribution of the coal asset is a compulsory dissolution by the direction of the court and in liquidation of the affairs of the Reading Company;

That the charter and certificates of the Reading Company are silent as to what shall be done in the event of dissolution or liquidation, and, therefore, it follows that all classes of stock share alike;

That this is not a distribution of net profits by way of a dividend; that it is the disposition of an asset which has been owned in specie by the Reading Company since the reorganization in 1896;

That the coal asset was never earned or could be earned by the Reading Company itself, nor was it paid for out of earnings or net profits;

That the stock certificates provide that after providing out of net profits of any year for dividends on the first and second preferred stock, the directors may declare out of "surplus net profits" of such year dividends upon the common stock;

That the only words of limitation of any kind on the rights of the preferred stockholders are contained in the clause establishing dividends "at the rate of but not exceeding four per cent."

We also pointed out; that the Plan provides for the merger of the Reading Company with the Railway Company and the surrender by the Reading Company of all powers not appropriate for a railroad corporation of Pennsylvania; that the special charter of the Reading Company will be terminated; that the merged corporation will be subject, as a common carrier, to the laws of the United States and to the Constitution and laws of Pennsylvania; that under the decisions of Pennsylvania the effect of such a merger is a dissolution destroying the actual identity of both companies (Iselin brief, pp. 28-30).

In this memorandum we shall recite in some detail the history of the acquisition of the coal asset; this will make clearer the statement that the disposition of these assets is in no sense a distribution of profits by way of a dividend within the meaning of the clause contained in the stock certificates, which provides that dividends shall be paid "out of net profits."

On this subject, the court below said, Circuit Judge Buffington writing the opinion, concurred in by Circuit Judge Davis and District Judge Thompson (R. 281-282):

> "From these considerations it is apparent that whatever this disposition of the stock may be called, it is in no sense an earning of the Reading Company which is to be disposed of by that company as a dividend. It is a taking by the law of an asset of that company, a stock asset, which was and has been owned in specie by Reading Company since the Reading reorganization was formed, and which never was earned or could be earned by the Reading Company itself. Indeed it is now disposed of in substantially the same way as the law would dispose of the property of that company

were it being dissolved, and in that connection we deem it proper to say that, under the facts and circumstances before us, the legal question of dividend distribution between different classes of stockholders is not here involved, and on that question we express no present opinion for the simple reason that we are not dividing profits or earnings.

"Seeing then that this stock is not an earning of the Reading Company to be distributed as a dividend, but is a part of its capital disposed of in this case to qualifying shareholders, in the manner provided for by the creation of this intermediate corporation, it will be apparent that this decree of equal right to all shareholders, preferred and common alike, to participate in the sale as ultimate purchasers, is based on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets."

Ever since the Philadelphia & Reading Railroad Company, the predecessor of the Railway Company, began to acquire coal properties, in 1870, the production, purchase and sale of coal by the Coal Company, and the transportation of coal to market by the Railroad Company, have formed inseparable parts of one business, controlled by a single interest. In the early days, prior to 1896, the Coal Company was operated by and as a department of the Railroad Company which held all the stock of the Coal Company. Prior to 1896, the general mortgage and income bonds of the Railroad Company were secured by mortgages covering the coal properties of the Coal Company as well as the railroad of the Railroad Company, and the stockholders of the Railroad Company properly regarded the coal properties as one of the assets of their company.

The reports of the Railroad Company, beginning in 1871, emphasize the importance of the coal properties. Extracts from these reports appear in the record (R.

263, *et seq.*), and some are contained in the opinion of Mr. Justice CLARKE (R. 5, *et seq.*).

The importance of the coal properties has been frequently commented upon in the reports of the directors. In the annual report for 1893 of the Railroad Company, predecessor of the Railway Company, it was stated (R. 263):

> "For the last quarter of a century the maintenance of the integrity of the Reading System as a whole, and the preservation of the franchises of both the railroad and coal and iron companies so as to develop and operate the properties of both companies to advantage, have been regarded as of cardinal importance to all interested, either as creditors or as stockholders. No inventory and appraisement of separate items are of any importance, except so far as a statement of these assets may give an assurance of the permanence and growth of the income, unless it is proposed to sell the property in parcels, and such a method of realizing its value has never been seriously proposed."

The report then refers to the provision in the general mortgage of 1888 which requires the sale of the entire mortgaged property as a whole unless a majority of the bondholders direct the trustee to sell in parcels. The report continues:

> "It is thus manifest that any plan for the reorganization of the affairs of the Reading Companies must be based upon the maintenance of the property as an entirety and as a going concern."

In the report of the Philadelphia & Reading Railroad Company for 1894, it was stated (R. 264):

> "The management have always felt that of all branches of the business of the Reading Companies the most important and the most promising is the production and sale of anthracite. In all other departments the Reading Companies compete with rivals who are placed and equipped for business as well as or better than themselves, but

> in the coal business they have a vast undeveloped estate, which needs only time, patience, and resolution to develop profitably. To this development, both in producing and marketing the coal, they have devoted their best energies."

The single and all-controlling purpose in planning the reorganization of 1896 was to preserve the union of the coal properties and the railroad in one business and under a unified control.

The Reading Company, through the old Coal Company, acquired the vast coal holdings having in 1896 an estimated value of $95,000,000 by issuing in payment therefor and delivering en bloc $70,000,000 par value of preferred stock, a like amount of common stock and $50,369,000 general mortgage bonds of the Reading Company (R. 8 and 160). Those who took the preferred stock in 1896 invested their money in a company which was to carry on the business of producing, purchasing and selling coal and transporting it to market (Mr. Justice CLARKE, R. 9). The attractive feature to all who invested was the permanent union of the two industries,—coal mining and the transportation of coal. This union, they thought, would be profitable, and thirteen prominent attorneys and the Attorney-General of Pennsylvania advised them that it was lawful (R. 251-252).

Twenty-five years later it is held that the 1896 plan was and is unlawful and, by compulsion of law, the coal properties are to be severed from the railroad. The plan of disintegration provides that both classes of stockholders of the Reading Company, preferred and common, shall participate equally in the distribution of the coal assets, just as they participated equally in the acquisition of those assets in 1896 by paying like assessments. The appellants would set apart the vast coal properties for the benefit of the common to the exclusion of the preferred, on the theory that they can segregate the coal assets from the other assets, put them into a surplus, and then appropriate that part of the surplus by way of a dividend.

But by what process of reasoning can the disposition of the coal assets be described as a dividend "out of net profits"? As Judge BUFFINGTON said (R. 281):

> "It is in no sense an earning of the Reading Company which is to be disposed of by that Company as a dividend."

The coal assets formed part of the original enterprise and have always been an essential part of the security behind the preferred stock. The court continued (R. 281):

> "It is a taking by the law of an asset of that Company, which was and has been owned in specie by the Reading Company since the Reading reorganization was formed and which never was earned or could be earned by the Reading Company itself."

Counsel for the appellant must rest his entire case upon the words, "dividends at the rate of but not exceeding four per cent," for there is no other limitation of any kind on the rights of the preferred stockholders which does not also apply to the common. The requirement that dividends shall be paid "out of net profits" applies to the dividends on the common stock as well as on the preferred stock.

Therefore the appellant must establish that the distribution of the coal assets is a dividend. Otherwise his case falls. He may not enlarge the meaning of the clause, "dividends at the rate of but not exceeding four per cent." so as to make it include something which is not a dividend. If it had been intended to exclude the preferred stockholders from equal participation with the common in anything except dividends, either the stock certificates or the charter would have so provided. It is axiomatic that there are numerous other rights than the right to dividends. Neither the charter nor the certificate denies to the preferred stock equal participation in other rights than dividends, and, therefore, under the law of all jurisdictions the preferred are entitled to equal participation therein.

For example, the charter gives the preferred the right to subscribe to an increase in the capital stock, because it provides, "Should the capital stock be increased, the stockholders at the time of such increase shall be entitled to a pro-rata share of such increase upon the payment of the instalments thereon duly called for" (R. 194). (See our former brief p. 10). If the surplus should be paid out in the form of a stock dividend, the preferred would share equally with the common.

Another example: The charter and the certificates are silent in the event of the liquidation or dissolution of the Company. Therefore, under the law of Pennsylvania and of all other jurisdictions, the preferred stock has equal rights with the common in the assets of the Company upon liquidation.

If the stockholders of the Reading Company should refuse to take the corporate steps necessary to put into effect this or some other plan for the segregation of the coal properties, the court below will appoint receivers with instructions to bring about a condition in harmony with the law (Mandate, par. "Third" R. 37). The receivers would liquidate the assets. In such event the preferred and common would share alike.

We insist that as there is no limitation and as equality is equity, the preferred share equally with the common in all rights arising out of a distribution of the coal asset. The question of the respective rights on a distribution of other assets is not here involved and need not be considered. On this point, the lower court very pertinently said (R. 282):

> "We deem it proper to say that under the facts and circumstances before us, the legal question of the dividend distribution between different classes of stockholders is not here involved, and on that question we express no present opinion for the simple reason that we are not dividing profits or earnings."

We know of no decision holding that the surplus of a corporation is a trust fund for the benefit of the common stockholders, and must be preserved for them irrespective of the vicissitudes of the business In this case, the Reading Company carries on its books a claim against the Coal Company amounting to over $69,0000,000, upon which the Coal Company has paid interest at various times during the past twenty years. This item is also carried on the books of the Coal Company. If the preferred stockholders should be deprived of the security of the coal assets now behind their investment, and these assets should be given over entirely to the common without any participation by the preferred, we think the preferred would be justified in insisting on a settlement of the debt before the Reading Company executes the general release to the old Coal Company contemplated in the plan.

The present funded debt of the Reading Company is $132,756,000, and its capital stock, preferred and common, is $140,000,000. (See balance sheets, December 31, 1920, of Reading Company, Coal Company and old Railway Company, R. 198-200.) In the face of this huge funded debt and the capital stock issue, it is obvious that a surplus of $33,000,000 is inconsiderable.

After the plan has been carried into effect and the Reading Company merged with the Railway Company, the balance sheet will show a funded debt of $161,841,000, an increase of almost $30,000,000, while the capital stock will remain the same. (See consolidated balance sheet, last column, on page 200 of Record.) The surplus of the consolidated company will be $54,115,000, but this figure is practically identical with the "additions to property through income and surplus," previously carried by the Railway Company, which is explained in the answer of the Reading Company (R. 172-173). This figure represents betterments and additions which the rules of the Interstate Commerce Commission require to be capitalized, and which, otherwise, would have been charged to expenses.

Only in the event that the Reading Company is able to realize from the disposition of the coal assets an amount equal to the figure at which it carries those assets on its books, is it correct to say that it had a surplus of $33,996,000 at the end of 1920. It will be remembered that in April, 1920, this court had declared that the Reading Company must dispose of its coal assets. Included in the assets on the balance sheet of the Reading Company is the debt due from the Coal Company carried at $69,357,000, and the stock of the Coal Company at a valuation of $8,000,000. Therefore, unless the Reading Company realizes from the disposition of its coal assets their book value, $77,357,000, it would not be accurate to say it had a surplus of $33,996,000 at the end of 1920.

The Reading Company states in its answer (R. 162) that it is not material whether or not the debt of the Coal Company to it is a genuine debt, meaning that if the debt is cancelled, there will be a corresponding increase in the value of the capital stock of the Coal Company, which is entirely owned by the Reading Company. But the matter is material to the preferred stockholder if the preferred stockholder is excluded from participating in the value represented by the stock of the Coal Company. As pointed out above, the aggregate investment of $77,357,000 in the coal properties consists of two assets,—first, the debt of $69,357,000, and, second, the stock of the Coal Company. The court has directed the Reading Company to dispose of only one of these assets, namely, the stock of the Coal Company. Why should the preferred stockholder permit the value of that asset to be increased from $8,000,000 to $77,357,000 by a cancellation of the debt if the asset is then to be disposed of without any participation therein by the preferred stockholder? Should he not insist that the Reading Company collect its debt out of the Coal Company, or a large part of that debt, before the stock is surrendered? In that event, the surplus would be reduced according as the Reading Company received less than the entire amount of its claim.

IV.

The Fourth Question.

The fourth question for consideration on the reargument is:

> "What the basis is upon which the amount and character of the payments to be made by the Coal Company and by the new Company to the Reading Company was arrived at, and what the reasons are for adopting it."

The committee of preferred stockholders, whom we represent, we understand, did not participate in the conferences which resulted in the plan.

The balance sheet of the Coal Company at the close of 1920 shows total assets approximating $112,000,000 (R. 198). If we deduct from the foregoing figure all liabilities shown on the balance sheet with the exception of the debt to the Reading Company, we arrive at a figure of over $103,000,000 as the net value of the assets. But as stated, this does not take into account the debt of $69,357,000 to the Reading Company.

Moreover, the liability of the Coal Company on the general mortgage bonds is not carried on the balance sheet, although the Coal Company is joint obligor with the Reading Company and more than $93,000,000 of general mortgage bonds are outstanding.

The fourth question is discussed in the brief of the Reading Company, filed on this reargument, pages 44 *et seq.* (See also R. 163-164 and 167-168.)

It is therefore respectfully submitted that the decree should be affirmed.

GEORGE W. WICKERSHAM,
EDWIN P. GROSVENOR,

Solicitors for Adrian Iselin, et al., as a committee representing certain first and second preferred stockholders, Appellees,
40 Wall Street,
New York City.

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY and FIDELITY-PHENIX FIRE INSURANCE COMPANY OF NEW YORK,
Appellants,

AGAINST

READING COMPANY and Others,
Appellees.

No. 609

On Reargument

SEWARD PROSSER, MORTIMER N. BUCKNER and JOHN H. MASON, as a Committee, etc.,
Appellants,

AGAINST

READING COMPANY and Others,
Appellees.

No. 610

BRIEF FOR CENTRAL UNION TRUST COMPANY OF NEW YORK (HEREIN CALLED THE "MORTGAGE TRUSTEE") TRUSTEE OF THE GENERAL MORTGAGE OF READING COMPANY AND THE PHILADELPHIA & READING COAL & IRON COMPANY, DATED JANUARY 5TH, 1897.

Chronology.

1890.

The Sherman Law was enacted.

1897.

This Mortgage was executed.

1913.

This action *to which the Mortgage Trustee was not a party* was begun.

1920.

The decision of this Court declaring the Combination invalid was rendered.

This court, in its opinion directed, among other things, that the cause be remanded with directions to enter a decree in conformity with its opinion, dissolving the combination of the Reading Company, The Philadelphia & Reading Railway Company and the Philadelphia & Reading Coal & Iron Company, existing and maintained through the Reading Company, with such provisions *for the disposition of the shares of stock and bonds* and other property of the various companies *held by the Reading Company,* as may be necessary to establish the entire independence from that Company and from each other of the above named Companies.

February 4, 1921.

After the cause was remanded pursuant to the above direction, the Reading Company filed with the Court below a plan to carry out the decision of the Court (Record, p. 40).

This plan contained the first intimation throughout the litigation of any disturbance of the securities pledged with the Mortgage Trustee.

March 1, 1921.

The United States filed a supplemental bill to make the Mortgage Trustee a party (Record, pp. 48-51).

April 12, 1921.

The Court made such order (Record, pp. 203-205), and the Mortgage Trustee filed its answer alleging that it was not necessary to disturb the lien of the mortgage in order to carry out the mandate of the Court (Record, pp. 150-152).

June 6, 1921.

The Court made its final order which did not disturb the lien of the mortgage (Record, fols. 287-313).

June 16, 1921.

Assignments of error filed which in no wise raised any question affecting the Mortgage Trustee (Record, p. 317), and appeal allowed (Record, p. 320).

January , 1922.

Appeal argued, in which argument the Mortgage Trustee did not participate, as no question affecting it was raised by the assignments of error.

February 27, 1922.

Reargument ordered, and the Court subsequently through the clerk, stated that on the reargument special attention should be given to four stated questions, only two of which interest the Mortgage Trustee, viz.:

> "1. Whether the disposition by the Reading Company of the stock of the Philadelphia & Reading Coal & Iron Company, contemplated and ordered in the decree of the District Court, will establish such entire independence between the Reading Company, present and prospective, and the Philadelphia & Reading Coal & Iron Company, and the New Company to be organized, as is required by the opinion and judgment of this Court."
>
> "2. Whether the general mortgage having been executed, and the bonds secured by it issued, as a part of the process of forming the combination held to be unlawful, there is any legal or practical difficulty in providing, by appropriate modifications of the decree, for sale of the Coal Company stock, owned by the Reading Company, free from the lien of that mortgage and from the lien of the contemplated new mortgage."

POINTS.

I.

The decree of the District Court does provide for the segregation prescribed by the opinion of this court.

This point will, we assume, be argued at length by the counsel for the Reading Company, and the Solicitor General, and we will do no more than briefly point out the salient features of the plan that provided for the separation of interest in the coal property from interest in the railroad property.

(*a*) The general mortgage bonds are the joint obligation of the Reading Company and the Coal Company. By the plan, the Reading Company assumes the payment of the bonds, and agrees that at or before the maturity of the mortgage it will obtain a release of the coal lands from the general mortgage (Record, pp. 274-5).

(*b*) The Reading Company, *subject to the lien of the general mortgage* sells to a new company

(1) all its interest in the Coal Company stock;

(2) all its rights to vote thereon;

(3) all its rights to receive dividends thereon; and no dividends are to be declared on the Coal Stock, prior to the sale to the new company (p. 292).

(4) All the stock of the new company is to be issued to a trustee approved by the Court.

(5) Before acquiring stock in the new company, a prospective stockholder must make affidavit that he owns no stock in the Reading Company (the so-called Southern Pacific-Union Pacific method) (293).

(*c*) The new company is to submit to the jurisdiction of this Court by becoming a party to the action.

(*d*) The new company to have independent management approved by the Court.

(*e*) On default in the general mortgage, the Mortgage Trustee shall exercise the voting right, if it exercise it at all, so as not to bring about unity of management between the Coal Company and the Railroad Company; and if it sell the coal stock, it shall sell the same to interests different than that of the Reading Company (Record, p. 277).

(*f*) Jurisdiction of the suit is retained for the purpose of giving full effect to the decree, and making such order as may be necessary to carry out its enforcement (p. 302).

All the provisions were amply safeguarded by the decree approving the plan (Record, pp. 291-302).

II.

Any modification of the decree, providing for the sale of the Coal Company's stock, free from the lien of the General Mortgage, would present both legal and practical difficulties.

A.

The Bonds Secured by the Mortgage.

There are now upwards of $96,000,000 of these bonds outstanding.

They mature in 1997.

They bear a 4% interest rate.

According to the records of the Mortgage Trustee

about.....	$50,000,000	were issued at or about the date of the mortgage.
about.....	36,000,000	were issued between 1897 and 1920, to take up and in exchange for underlying bonds that were liens prior to the reorganization and for the most part dated prior to the passage of the Sherman Act (Art. I, Sec. 3 of General Mortgage).
about.....	20,000,000	were issued between 1898 and 1911 for betterments (Art. I, Sec. 4 of General Mortgage).
say	$106,000,000	
Retired by Sinking Fund, say.	10,000,000	
	$96,000,000	

The owners of these $96,000,000 of bonds are numerous and widely scattered, and few of them, if any, are in any way identified with the manage-

ment of the properties of the Reading Company or the Coal Company (Record, p. 152).

The answer of the Mortgage Trustee alleges that the bondholders have not, nor did they ever have, any part in the conspiracy set forth in the bill of complaint (Record, p. 152).

Many of the bonds are held by fiduciaries (Record, pp. 144-147).

B.

The Refunding Mortgage.

So far as the provisions of the mortgage relate to the pledge of the securities therein as collateral security for the payment of the bonds, they are in conventional form.

Some of its covenants, however, are particularly appropriate to the situation with which it dealt.

A perusal of the mortgage shows beyond doubt that the representation of the Reading Company to its bond purchasers was that they should at all times have as security for the payment of their bonds, both the Railroad and the Coal Company stocks.

All the stock and equipment of the Railroad is pledged (as well as all the stock of that Company), and a direct lien is given on the lands of the Coal Company, and while there is ample power given to the Trustee by the release clause to release other properties, it is expressly precluded from ever releasing either the Railroad or the Coal stock.

Until default the Reading Company has the right to vote and receive the dividends declared on the Coal Company stock.

After default these rights are in the Mortgage Trustee.

The decree of the District Court prevents the exercise of these rights in any way contrary to the decision of this Court by its provision for the payment of such dividends and voting of such stock, before default (Record, 296-7) and by its control of the Mortgage Trustee after default (Record, pp. 298, 302).

It would seem that the plan thus enables the Court to retain control of the future acts of the Reading Company for a much longer period than it could if it were to now order the sale of the Coal stock.

C.

As to the Legal Difficulties.

The authority of the Court to grant relief at the instance of the Government in cases of this description springs chiefly from Sections 1 and 4 of the Anti-Trust Act.

The material part of Section 1 of the Act is as follows:

> "Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal."

Section 4 of the Act provides:

> "The several Circuit Courts of the United States are hereby vested with jurisdiction *to prevent and restrain violations of this Act;* and it shall be the duty of the several district attorneys of the United States, in their respective districts under the direction of the Attorney General to institute proceedings in equity *to prevent and restrain such violations;*

> such proceedings may be by way of petition setting forth the case and praying that such violations *shall be enjoined or otherwise prohibited.*" (Italics ours.)

It is to be noted that the purpose of a suit authorized by the Statute is "to prevent and restrain violations of the Act". If therefore there is no violation of the Act there is nothing to be prevented or restrained.

This Court found that the Reading Company, the Coal Company and the Railway Company were parties to an illegal conspiracy. It did not find, nor can it be found, upon the facts, that the holders of the general mortgage bonds are parties to or in any way connected with such conspiracy, hence the valid pledge for their benefit of the securities in question, to wit, the Coal Company stock is not a "contract . . . or conspiracy in restraint of trade or commerce among the several states, or with foreign nations". It follows there is no violation of the Act by the pledge and therefore in this suit this Court should not disturb the pledge.

It may be argued that because the Reading Company, the Coal Company and the Railway Company have been found by this Court to be parties to an unlawful conspiracy, therefore, the valid pledge of the stock of the Coal Company for the benefit of innocent third parties, to wit, the general mortgage bondholders, can be disturbed. This does not follow. The rule as laid down by the decisions of this Court and other Federal courts clearly recognizes that not all the acts of a party to an illegal combination are subject to the prohibition of the Act. It is only *a direct act in restraint of trade* that constitutes a violation of the Act and therefore is subject to redress. Collateral acts, *even of an illegal*

combination in restraint of trade, are not within the prohibition of the Act.

Connelly v. *Union Sewer Pipe Co.* (1901), 184 U. S. 540;
Wilder Mfg. Co. v. *Corn Products Co.* (1914), 236 U. S. 165;
Chicago Wall Paper Mills v. *General Paper Co.* (1906), 147 Fed. 491;
Boatmen's Bank of St. Louis, Mo., v. *Fritzlen* (1915), 221 Fed. 145, 146.

In the *Connelly* case, the Union Sewer Pipe Company brought suit against the defendant Connelly on two negotiable promissory notes given by the defendant to the plaintiff on account of the purchase by the defendant from the plaintiff of sewer pipe. The defendant set up as a special defense to the plaintiff's cause of action "that the plaintiff was a combination in the form of a trust in restraint of trade and commerce among the several states . . . and that this action is brought solely to recover the price of articles of merchandise, to wit, sewer and drain pipes, sold to the defendant by the plaintiff then and there acting and doing business as such a combination, as aforesaid, in violation of the provisions of said Act."

The Court, in overruling this contention, said, page 550:

> "But the act does not declare illegal or void any sale made by such combination, or by its agents, of property it acquired or which came into its possession for the purpose of being sold—such property not being at the time in the course of transportation from one State to another or to a foreign country. The buyer could not refuse to comply with his contract of purchase upon the ground that the seller was an illegal combination which might be re-

strained or suppressed in the mode prescribed by the act of Congress; *for Congress did not declare that a combination illegally formed under the act of 1890 should not, in the conduct of its business, become the owner of property which it might sell to whomsoever wished to buy it.* So that there is no necessary legal connection here between the sale of pipe to the defendants by the plaintiff corporation and the alleged arrangement made by it with other corporations, companies and firms. The contracts under which the pipe in question was sold were, as already said, collateral to the arrangement for the combination referred to, and this is not an action to enforce the terms of such arrangement. That combination may have been illegal, and yet the sale to the defendants was valid." (Italics ours.)

In *Chicago Wall Paper Mills* v. *General Paper Co., supra,* the Circuit Court of Appeals for the Seventh Circuit, after pointing out that the sale of merchandise by an unlawful combination is not rendered void by the Anti-Trust Act of the State of Illinois, said, page 494:

> "The same distinction has been drawn under the federal anti-trust act (*Hopkins* v. *United States,* 171 U. S. 578, 592, 19 Sup. Ct. 40, 43 L. Ed. 290; *Anderson* v. *United States,* 171 U. S. 604, 615, 19 Sup. Ct. 50, 43 L. Ed. 300), and this court has several times held that contracts founded upon a good consideration are collateral to the unlawful scheme or combination and not tainted thereby. *Dennehy* v. *McNulta,* 86 Fed. 825, 30 C. C. A. 422, 41 L. R. A. 609; *Star Brewery Co.* v. *United Breweries,* 121 Fed. 713, 58 C. C. A. 133; *Harrison* v. *Glucose Co.,* 116 Fed. 304, 53 C. C. A. 484, 58 L. R. A. 915."

In *Boatmen's Bank of St. Louis, Mo.,* v. *Fritzlen, supra,* the question of the validity of a loan of

money was before the Circuit Court of Appeals, Eighth Circuit. The Court in holding that the defense of the Kansas Anti-Trust Act was not a bar to the cause of action of the Bank for the recovery of the money loaned, said, page 165:

> "The bank parted with some $10,000 of its money upon the agreement that that amount should be repaid and that the notes it held as collateral should likewise be paid. It was to get two benefits: The payment of its advances; the realization upon its collateral. We think that this was as an entirety a valid agreement between Fritzlen and the bank. It was not a contract to carry out restrictions in trade or commerce. It was a contract for the payment of money it had loaned, and which presumably it loaned in part because and as a result of the transaction it was getting security also to satisfy its collateral. The motive which moved the bank was a perfectly honest and proper one, and had nothing in it violative of the Anti-Trust Act."

The language of the above cases makes it clear that the pledge of the Coal Company stock by the Reading Company under the General Mortgage is a valid, legal and subsisting act. This Court, therefore, is not empowered by the Anti-Trust Act, or by any authority with which it is vested, to impair or abrogate the terms of the mortgage by compelling the release of the Coal Company stock therefrom.

D.

As to Equitable Considerations.

We have seen that about fifty per cent. of the general mortgage bonds now outstanding were issued from time to time after the execution and delivery of the general mortgage, to wit, after Jan-

uary 5, 1897, and certain of them as late as 1920. We have likewise seen that the covenant not to release stock of any corporation, all of whose stock or a majority of which was pledged under the general mortgage, assured to bondholders that the Coal Company's stock would never be released from that instrument.

Though these provisions clearly appear in the mortgage and all parties openly proceeded under the plan from the time the same was declared operative, it was not until the filing of the present bill in September, 1913, nearly seventeen years after the promulgation of the plan and over fifteen years after the date of the general mortgage, that the Government or anybody else in any way questioned the validity and legality of the scheme or gave any notice of disapproval thereof, and even then no attempt was made to disturb the general mortgage.

A very large proportion of the bonds now outstanding are reserved bonds issued pursuant to the mortgage provisions hereinbefore referred to and taken and accepted by the holders thereof upon the assurances contained in the general mortgage and upon the assumption that the Reorganization Plan was valid and legal and the property covered by the mortgage would not be disturbed. This assumption was certainly justified because the Reading Company had been allowed to proceed for many years unchallenged in carrying out the provisions of the plan and the covenants of the general mortgage. It was natural therefore that such bondholders concluded that the plan had the approval of the authorities. We, therefore, submit on behalf of such bondholders that their position should be carefully considered by the Court, and as we have shown full compliance with the provisions of the

mandate of this Court can be had without disturbing the general mortgage, such bondholders should be left with the lien for which they bargained.

There is another class of these general mortgage bondholders who are entitled to still greater consideration and that is the holders of "outstanding old bonds" (which are really underlying bonds and which hereafter will be designated as such), who exchanged the same for general mortgage bonds under the provisions of Article One, Section 3.

The general mortgage was subject to certain underlying mortgages securing underlying bonds, which mortgages were prior liens upon some, but not all, of the mortgaged and pledged properties. The general mortgage covenants in Article Two, Section 5, that these underlying bonds, when they mature, may be extended or new bonds may issue with lien prior to that of the general mortgage. It also covenants in Article One, Section 3, that the holders of such underlying bonds may, if they desire to do so, surrender the same and take general mortgage bonds instead.

Between the date of the promulgation of the plan, 1895, and the commencement of this action, 1913—at that time there being no challenge as to the legality of the scheme—many of the holders of such bonds, relying upon the covenants of the mortgage, availed themselves of the right to exchange the underlying bonds for general mortgage bonds. It follows therefore that all general mortgage bonds so issued were unquestionably issued upon the faith of the covenants of the general mortgage and in reliance upon the validity thereof and such exchanging bondholders were justified in assuming, by reason of the length of time which had elapsed during which the plan was being openly carried

out, that the mortgage was valid and its covenants would be observed. It would seem, therefore, that underlying bondholders who exchanged their bonds for general mortgage bonds during the seventeen years intervening between the promulgation of the plan and the filing of this action, by reason of the length of time which had intervened and the fact that the Government had taken no steps to question the plan, were authorized to and did assume that the plan was approved; hence, such underlying bondholders *having changed their position* in reliance upon the covenants of the general mortgage and upon the justified assumption that the scheme of control therein outlined was legal, are entitled to and should receive from a court of equity due consideration, and their rights should be protected by not disturbing the lien for which they bargained and of which they were assured at the time they made the exchange in question.

E.

As to Practical Difficulties.

While it is true that the general mortgage is one of the instrumentalities through which the plan of reorganization of 1895 was effected, and the subsequent operation of the combination resulting from that plan has been condemned as an illegal combination, nevertheless, the mere fact that the general mortgage was a portion of such plan does not necessarily make *that* instrument illegal or improper.

We submit that an analysis of the opinion of this Court and of the record upon which the same was based, and also of the present record, clearly shows no defect in the general mortgage. The Reading Company and the Coal Company had a perfect

right to pledge their property and securities for the purpose of obtaining the advances received from or of extinguishing the debts paid by, the general mortgage bonds. It is not the pledge of such securities and properties, nor the holding thereof for the benefit of the general mortgage bonds, as provided in the general mortgage, that is condemned, but it is the use by the Reading Company of the powers reserved in respect to such securities and properties over and above the rights given to the Trustee of the general mortgage and its bondholders, that has been found to be illegal, therefore, as the instrument itself and the acts done thereunder are in no wise tainted with illegality, nor are the beneficiaries under that instrument parties to the illegal conspiracy, there is no necessity of disturbing that instrument in order to cure the evils complained of.

We have seen that by the provisions of Article Sixth of the general mortgage it was covenanted that the stocks of any company of which all or a majority were pledged would not be released from such mortgage during its life. In other words, that is a promise to investors, hoping to induce them to put their money in the enterprise and upon which they have a right to rely, that their security will always be twofold, and their investment will not be at the hazard of a single enterprise. This may well have been a very potent inducement to those investing in the general mortgage bonds, and particularly so, where, as we have seen above, the right of the Reading Company to thus pledge its properties and securities was unchallenged by the United States or by any one else for many years after the plan was put in operation.

It must be borne in mind that the Reading Company has succeeded in very advantageously placing about $96,000,000 of 4% Bonds, which will not mature until 1997, and it may be claimed that the release of the stock of the Coal Company, even if made pursuant to a decree of this Court, will be a breach of the covenants of the mortgage, by reason of which the general mortgage bondholders will have a right to insist upon the enforcement of the default provisions of the mortgage resulting in an acceleration of the maturity of the principal of the bonds and a sale of the property and securities pledged to satisfy the mortgage debt thus precipitated. Such a result would certainly be calamitous to the Reading Company. The court will take notice of the fact that it would be impossible under the present money conditions to replace this financing except at a cost of many millions of dollars, if at all.

It is submitted therefore that where the result sought to be accomplished can be legally and effectively reached without these disastrous consequences, that the course followed should be one by which this peril is avoided, and therefore the lien of the general mortgage should not be disturbed.

III.

The lien of the general mortgage should not be disturbed.

Dated, April 5th, 1922.

LARKIN, RATHBONE & PERRY,
Solicitors for Central Union Trust
Company of New York, Trustee
under the General Mortgage,
80 Broadway,
New York City.

JOHN M. PERRY,
ARTHUR H. VAN BRUNT,
of Counsel.

In the Supreme Court of the United States.

OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY AND Fidelity-Phenix Fire Insurance Company of New York, appellants,
v.
THE UNITED STATES OF AMERICA, Reading Company, The Philadelphia & Reading Coal & Iron Company, et al.
} No. 609.

SEWARD PROSSER, MORTIMER N. BUCKNER, and John H. Mason, as a committee representing holders of common stock of the Reading Company, appellants,
v.
THE UNITED STATES OF AMERICA, Reading Company, Philadelphia & Reading Coal & Iron Company, et al.
} No. 610.

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

MEMORANDUM FOR THE UNITED STATES.

The appellants, holders of common stock and representatives of holders of common stock of Reading Company, challenge the right of holders of

the first and second preferred stock to participate equally with holders of common stock in certain alleged benefits resulting from the dissolution of the so-called Reading combination pursuant to the mandate of this court.

The question raised by the appeals, involving alleged conflicting rights of different classes of stockholders of Reading Company, is neither one of general public importance nor one in which the United States has a direct or special interest.

The United States, however, has a vital interest in upholding the power of district courts to work out dissolutions of corporate combinations under the antitrust act. And in particular the United States is concerned in upholding their discretion to make such disposition of the stock of any one member of such combination, held by any other, as may be necessary effectually to terminate the offending relation.

On the former appeal (253 U. S. 26) this court remanded the cause to the District Court with instructions to enter a decree in conformity with its opinion,

> dissolving the combination of the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad Company of New Jersey, and the Lehigh & Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading

> Company, as may be necessary to establish the entire independence from that Company and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad Company of New Jersey, and the Lehigh & Wilkes-Barre Coal Company. (Rec. 25.)

On receipt of the mandate an interlocutory decree was entered (Rec. 31) requiring defendants to file in the District Court within 90 days a plan of dissolution. The relations between the several corporate defendants were extremely intricate, and so far as the Reading group was concerned the situation was complicated by the existence of an underlying general mortgage. The problem of working out a plan which, while effectually dissolving the unlawful combination, would not unduly affect property rights innocently acquired was one of great difficulty.

In *United States* v. *American Tobacco Co.* (221 U. S. 106, 185) this court enumerated the controlling factors in working out a decree of dissolution under the antitrust act as follows:

> 1. The duty of giving complete and efficacious effect to the prohibitions of the statute; 2, the accomplishing of this result with as little injury as possible to the interest of the general public; and, 3, a proper regard for the vast interests of private property which may have become vested in many persons as a result of the acquisition either by way of stock ownership or otherwise of interests in the stock or securities of the combination without any guilty knowledge or intent in

> any way to become actors or participants in the wrongs which we find to have inspired and dominated the combination from the beginning.

And in the *Northern Securities case* (193 U. S. 197, 360) the court said:

> This, it must be remembered, is a suit in equity, instituted by authority of Congress "to prevent and restrain violations of the act," sec. 4; and the court, in virtue of a well-settled rule governing proceedings in equity, may mould its decree so as to accomplish practical results—such results as law and justice demand.

A plan was finally evolved after numerous conferences between counsel for the defendants and Government counsel and between counsel for both parties and the court. It met the views of the Attorney General in every particular save one. (Rec. 45.) Numerous petitions to intervene filed by the different classes of stockholders and the bondholders were allowed without objection. (Rec. 203.) To meet the objections of the bondholders the plan was modified so as not to disturb the security of the general mortgage, and as modified the plan was approved by the United States. (Rec. 274.)

As regards the disposition by Reading Company of the stock of Philadelphia & Reading Coal & Iron Company, the plan, after providing for the assumption by Reading Company of the entire burden of general mortgage and the cancellation of the coal company's indebtedness to it, provides that Reading

Company will sell to a new corporation to be organized its equity in such stock for the sum of $5,600,000. The new corporation will issue to trustees 1,400,000 shares of capital stock of no par value, being one-half share for each outstanding share of Reading stock. The trustees will then issue beneficial certificates of interest representing such stock, which will be offered to Reading Company's stockholders, preferred and common, share and share alike, for $5,600,000, or $2 for each share of Reading stock.

The certificates of interest, which will be transferable, may be exchanged for actual shares of the new corporation upon the holders making affidavit in the prescribed form that they own no stock in Reading Company. Pending such exchange the trustees will exercise all voting rights and collect all dividends. As the certificates are exchanged the trustees will pay over to the holders all accumulated dividends. (Rec. 274, 292.) When the process is completed Reading Company, and the new company which will succeed to its interest in the coal company, will be under separate and distinct ownership, since their stocks will be held by different persons. The plan, moreover, will result in a wider distribution of the stock than if it were to be disposed of by Reading Company in a block.

Appellants objected to this feature of the plan because the preferred stockholders were permitted to participate in the purchase of the certificates of interest. Their contention was, that since the certificates were supposed to have a value in excess of

the subscription price the transaction constituted a distribution of earnings, and that, since the preferred stockholders were entitled to participate in earnings only to the extent of 4 per cent per annum and had received their allotted percentage annually in the form of dividends, either they should not participate in the benefits of the plan or a different plan should be devised.

The District Court held (273 Fed. 848; Rec. 278) that the coal company stock was a capital asset of Reading Company, owned in specie since the reorganization in 1896; that it was not and could not have been earned by Reading Company, and that, consequently, the legal question of dividend distribution between different classes of stockholders was not involved. The court, therefore, concluded:

> Seeing then that this stock is not an earning of the Reading Company to be distributed as a dividend, but is a part of its capital disposed of in this case to qualifying stockholders, in the manner provided for by the creation of this intermediate corporation, it will be apparent that this decree of equal right to all shareholders, preferred and common alike, to participate in the sale as ultimate purchasers, is based on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets. (Rec. 282.)

The court further pointed out that the opposition to the plan represented but a small percentage of the

total stock of Reading Company; that the plan had the "silently expressed approval" of a majority of the common shareholders, and the positive approval of one block of 100,000 shares of common stock. The opinion is important in this connection as showing the principles on which the plan was worked out and the considerations which led to its approval:

> And in approving such plan we note that in point of fact the equity of a common participation of all stockholders, preferred and common, has not only the approval of the Government of the United States that has no interest in the controversy, save to see that equity is done to all; of the Reading Company, which has no interest save an impartial stewardship for all its shareholders; and lastly, the silently expressed approval of substantially two-thirds of the shares held by common stockholders. This significant and impressive fact cannot but be regarded as highly persuasive of the substantial equity of this plan. Of the 1,400,000 shares of the common stock of the Reading Company, less than one-third object to it. The other two-thirds, having had the opportunity to object and failing to do so, we are warranted in treating as acquiescing in the proposed plan. Indeed, we are justified from one circumstance in concluding from the positive attitude of a hundred thousand of those shares that the remainder are not only passively acquiescing but really actively approving. This particular block of a hundred thousand shares of the common stock is represented by one man who is a trustee of an estate which owns it, and

> he himself is the owner of one-half of such trust estate. He or the estate have no preferred stock whatever. He is also a director of the Reading Company and as such favored the plan. By his counsel he appeared at the hearing and strongly urged its adoption, asserting his consent to the preferred stock sharing equally with the common in the disposition of the shares of the coal company. His contention was that this equal participation by common and preferred stockholders was not only fair, legal, and equitable, but that such a proportionate division tended to the welfare of all parties concerned and indeed was a course which made the plan possible. When it is considered that the nonparticipation of the preferred stockholders in the shares of the coal company and the absorption of all the stock by the common shareholders would have benefited this particular hundred thousand shares by a large sum, this court may rest assured that the proposed plan by its equality works equity. Without entering upon a further discussion of the questions involved, we are of opinion, after careful and matured consideration, that the plan as amended should be approved, and we therefore direct the preparation of a formal decree embodying its terms. (Rec. 282–283.)

The mandate of this court directing a dissolution of the combination was general in terms and necessarily conferred on the District Court a broad discretion as to how the result should be accomplished. The requirement was not within the contemplation of the organizers of Reading Company, and there

were no provisions in the charter or by-laws with respect to the respective rights of common and preferred stockholders in such a contingency. The District Court, therefore, applied to the situation general equitable principles and "moulded its decree so as to accomplish practical results—such results as law and justice demand." The result has proven satisfactory to the vast majority of Reading stockholders, and it is submitted that the decree should not be disturbed at the instance of a small minority except for very grave reasons—certainly not on a narrow question of technical right as between different classes of stockholders.

January, 1922.

JAMES M. BECK,
Solicitor General.
GUY D. GOFF,
Assistant to the Attorney General.
ABRAM F. MYERS,
Special Assistant to the Attorney General.

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